

No. 11829

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United States  
Circuit Court of Appeals  
For the Ninth Circuit.

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MITCHELL CAMERA CORPORATION,  
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

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Transcript of the Record

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Upon Petition to Review a Decision of the Tax Court  
of the United States

FILED

MAR - 4 1948

PAUL P. O'BRIEN

CLERK



No.11829

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United States

**Circuit Court of Appeals**

**For the Ninth Circuit.**

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MITCHELL CAMERA CORPORATION,

Petitioner,

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COMMISSIONER OF INTERNAL REVENUE,

Respondent.

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**Transcript of the Record**

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**Upon Petition to Review a Decision of the Tax Court  
of the United States**

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Received of the Treasurer of the  
Board of Education the sum of  
\$100.00 for the year 1880

Witness my hand and seal this  
1st day of January 1880

Attest: My hand and seal this  
1st day of January 1880

Witness my hand and seal this  
1st day of January 1880

Attest: My hand and seal this  
1st day of January 1880

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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## APPEARANCES

For Taxpayer:

**HARRY FRIEDMAN, ESQ.**

For Commissioner:

**E. M. WOOLF, ESQ.**

The Tax Court of the United States  
Docket No. 8058

MITCHELL CAMERA CORPORATION,  
Petitioner,  
vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

DOCKET ENTRIES

1945

May 15—Petition received and filed. Taxpayer notified. Fee paid.

May 15—Copy of petition served on General Counsel.

May 17—Request for Circuit hearing in Washington, D. C., filed by taxpayer. 5/18/45 granted.

June 20—Answer filed by General Counsel.

June 23—Copy of answer served on taxpayer—Washington, D. C.

Oct. 25—Hearing set 12/10/45.

Nov. 19—Motion for continuance to a future Washington calendar filed by taxpayer. 11/19/45 granted to next Washington calendar.

1946

Apr. 29—Hearing set 6/4/46 at Washington, D. C.

May 31—Motion for a continuance to the next Washington, D. C., calendar filed by taxpayer. 5/31/46 granted.



1946

Aug. 19—Hearing set Oct. 21, 1946, at Washington, D. C.

Oct. 22—Hearing had before Judge Leech on  
23 merits. Petitioner granted leave to file amended petition to conform to the proof. Returned subpoena. Stipulation of facts filed at hearing. Petitioner's brief due 12/9/46, respondent's 1/8/47, petitioner's reply 1/23/47.

Oct. 29—Transcript of hearing of 10/22/46 filed.

Oct. 29—Transcript of hearing of 10/23/46 filed.

Nov. 4—Amended petition filed by taxpayer.  
11/5/46 copy served.

Nov. 18—Answer to amended petition filed by General Counsel.

Dec. 9—Brief filed by taxpayer. 12/10/46 copy served.

1947

Jan. 8—Motion for extension to Feb. 7, 1947, to file brief filed by General Counsel. 1/9/47 granted and petitioner to 2/24/47.

Feb. 7—Brief filed by General Counsel.

Feb. 24—Reply brief filed by taxpayer. 2/25/47 copy served.

June 24—Memorandum findings of fact and opinion rendered, Leech, J. Decision will be entered under Rule 50. 6/25/47 copy served.

1947

July 24—Motion to vacate and set aside the memorandum findings of fact and opinion filed by taxpayer. 7/25/47 denied.

Aug. 26—Computation for entry of decision filed by General Counsel.

Sept. 4—Consent to Computation filed by taxpayer. [1\*]

Sept. 9—Decision entered, Leech, J., Div. 6.

Nov. 3—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, with assignments of error filed by taxpayer.

Nov. 3—Proof of service filed.

Dec. 12—Certified copy of an order from the 9th Circuit extending the time to January 20, 1948, to prepare and transmit record filed.

Dec. 29—Certified copy of an order from the 9th Circuit directing the Clerk of the Tax Court to transmit all of the original exhibits ten days before this cause is set for argument to the Clerk of 9th Circuit filed.

1948

Jan. 2—Agreed statement of evidence filed.

Jan. 2—Statement of points filed by taxpayer with proof of service thereon.

Jan. 2—Designation of record filed by taxpayer with proof of service thereon. [2]

[Title of Tax Court and Cause.]

### AMENDED PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Symbols LA:IT:90D:PB, dated February 27, 1945) and as a basis of its proceeding alleges as follows:

1. The petitioner is a corporation with principal office at 665 North Robertson Boulevard, Los Angeles, California. The return for the period here involved was filed with the Collector for the Sixth District of California.

2. The notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to the petitioner on February 27, 1945.

3. The taxes in controversy are income and declared value excess profits taxes for the calendar year 1941 in the sums of \$71,301.66 and \$2,177.28, respectively, a total of \$73,478.94, all of which is in dispute.

4. The determination of tax set forth in said notice of deficiency is based upon the following errors:

(1) Determination of the basis of patents and applications for patents and inventions (hereinafter referred to as patents) acquired on July 25, 1929, as \$1,180,157.59 instead of \$2,860,178.95, the cost to petitioner. [3]

(2) Computation of patent depreciation on basis of average life of patents, instead of on the basis of life of patents exhausted within the years involved.

(3) Failure to allow patent depreciation in the sum of \$133,578.91, \$128,538.19 and \$128,528.19 in the years 1939, 1940 and 1941, respectively.

(4) Disallowance of ordinary and necessary expenses designated "special expenses" in the sums of \$1,637.50, \$1,583.71 and \$3,836.60 in the years 1939, 1940 and 1941, respectively.

(5) Disallowance of ordinary and necessary expenses designated as "New York office expenses" in the amount of \$11,161.88 and \$1,574.17 in computing the net operating loss for 1939 and 1940, respectively.

(6) Failure to allow the net operating loss carry-over in the amount of \$124,168.42, from 1939 to 1940.

(7) Failure to allow the net operating loss carry-over in the amount of \$226,817.69 from 1939 and 1940 to the taxable year.

5. The facts upon which the petitioner relies as a basis of this proceeding are as follows:

(1)(a) On July 29, 1929, the petitioner acquired from H. L. Clarke the assets, real property, equipment and patents of the Mitchell Camera Corporation of California for the sum of \$3,100,000.00 in cash. Included in the property so purchased were

tangible assets having a fair market value of \$239,821.05. The principal assets of the said Mitchell Camera Corporation of California were a group of patents having on date of acquisition expiration dates extending beyond the taxable year. The cost of the said patents to the petitioner was \$2,860,178.95.

(1)(b) The respondent in computing the deficiency erroneously considered as the cost of said patents the sum of \$1,180,157.59, determining said amount by deducting from the price of \$1,475,000.00 previously paid by [4] Harley L. Clarke to the stockholders of Mitchell Camera Company of California under a contract dated June 6, 1929, the sum of \$294,841.41, the purported net value of the tangible assets acquired from H. L. Clarke.

(1)(c) The cost of said property to H. L. Clarke was \$1,825,000.00 or more, the difference being the sum of \$350,000.00 to \$400,000.00 paid by H. L. Clarke as commissions to complete his purchase.

(2)(a) The life of the patents acquired was 4452 months. During the years 1939, 1940 and 1941 the life of patents exhausted was 212, 204 and 204 months, respectively.

(2)(b) The respondent in determining the deficiency computed patent depreciation on the basis of the average life of the patents exhausting the said patents prior to the expiration of their life, although the life of the patents had not expired.



(3)(a) The respondent in computing the deficiency allowed patent depreciation on patents acquired in 1929 in the amounts of \$95,430.50 for the year 1939, \$49,187.34 for the year 1940 and none for the year 1941.

(3)(b) The patent depreciation sustained by the petitioner in the years 1939, 1940 and 1941 computed on the basis of the proportion of the exhausted life within the respective years to the total life of the patents, was \$133,578.91, \$128,538.19 and \$128,538.19, respectively.

(4)(a) The petitioner incurred and paid ordinary and necessary expenses in connection with its business designated as "special expenses" in the sums of \$1,637.50, \$1,583.71 and \$3,836.60 in the years 1939, 1940 and 1941, respectively.

(4)(b) The respondent disallowed said "special expenses" in computing the deficiency.

(5)(a) In the taxable years 1939 and 1940 the petitioner incurred and paid ordinary and necessary expenses in connection with its business designated as "New York office expenses" in the amounts of \$11,161.88 and [5] \$1,574.17.

(5)(b) The said sums were expended for rent of space in New York and salaries of employees, and other incidental expenses.

(5)(c) The respondent allowed no portion of said sums in computing the net operating loss for the years 1939 and 1940.

(6) The net operating loss carry-over from 1939 to 1940 was \$124,168.42. The respondent allowed \$56,927.79.

(7) The net operating loss carry-over from 1939 and 1940 to 1941 was \$226,817.69. The respondent allowed \$39,100.79.

Wherefore, the petitioner prays that this Court may hear the proceeding, disallow the deficiency and grant such further and other relief as the nature of the case may warrant.

/s/ HARRY FRIEDMAN,  
540 Munsey Building,  
Washington, D. C.,  
Counsel for Petitioner.

State of New York,  
County of New York—ss.

Eva Fox, being duly sworn, says that she is president of the petitioner above-named, that she has read the foregoing petition, and is familiar with the statements contained therein and that the statements contained therein are true.

/s/ EVA FOX.

Subscribed and sworn to before me this 1st day of November, 1946.

/s/ WILLIAM S. ALTMAN,  
Notary Public. [6]

## EXHIBIT A

[Letterhead Treasury Department]

February 27, 1945

Office of Internal Revenue Agent in Charge, Los  
Angeles Division. LA:IT:90D:PB

Mitchell Camera Corporation  
665 North Robertson Boulevard  
Los Angeles 46, California.

Gentlemen:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1941, discloses a deficiency of \$71,301.66, and that the determination of your declared value excess-profits tax liability for the year mentioned discloses a deficiency of \$2,177.28, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los



Angeles, California, for the attention of LA:Conf. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency or deficiencies and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,  
Commissioner.

By GEORGE D. MARTIN,  
Internal Revenue Agent  
in Charge.

Enclosures:

Statement

Form of Waiver [7]

Statement

Mitchell Camera Corporation  
665 North Robertson Boulevard  
Los Angeles 46, California

Tax Liability for the Taxable Year  
Ended December 31, 1941

	Liability	Assessed	Deficiency
Income tax .....	\$71,301.66	None	\$71,301.66
Declared value excess profits tax.....	2,177.28	None	2,177.28
Total .....	<u>\$73,478.94</u>	<u>None</u>	<u>\$73,478.94</u>

In making this determination of your tax liability careful consideration has been given to the report of examination dated October 14, 1943, to your protest dated February 10, 1944, and to the statements made at the conference held.

A copy of this letter and statement has been mailed to your representative, Mr. Sidney R. Reed, 608 South Hill Street, Los Angeles 14, California, in accordance with the authority contained in the power of attorney executed by you.

### Adjustments to Net Income

Net income (loss) as disclosed by return.....		(\$7,121.24)
Unallowable deductions and additional income:		
(a) Depreciation disallowed....	\$ 93,578.16	
(b) Special expense disallowed	3,836.60	
(c) Bad debt disallowed.....	4,676.78	
(d) Interest income understated .....	15,479.56	
(e) Net operating less deduction disallowed.....	124,101.71	241,672.81
		<hr/>
Total .....		234,551.57
Additional deduction:		
(f) Capital stock tax.....		1,562.50
		<hr/>
Net income adjusted.....		\$232,989.07

## Explanation of Adjustments

(a) After consideration of the facts with regard to your corporate organization in 1929 and in view of the contract of June 6, 1929, between Harley L. Clarke and H. F. Boeger, acting for himself and George A. Mitchell and others, it is determined that the basis for computation of allowable [8] depreciation on a group of patents and patent applications acquired by you on July 27, 1929, is \$1,180,157.59; further that, inasmuch as no allocation of that basis to each separate patent or application has been established, the above amount is recoverable through depreciation allowances over the average life of the entire group of patents, i.e., over a period of 12.3666 years from July 27, 1929; and it is held that for the calendar year 1941 you are entitled to a deduction of \$1,027.76 as allowable depreciation or amortization of patents and excessive depreciation deducted, amounting to \$93,578.16 is disallowed in accordance with the following computation:

	Patents		Allowed to 12-31-38	Depreciation			Total to 12-31-41
	Acquired	Cost		1939	Allowable 1940	1941	
7/25/29 .....		\$1,180,157.59	\$1,035,539.75	\$95,430.50	\$49,187.34	None	\$1,180,157.59
Add'ns to 12/31/38..		15,627.83	5,618.49	917.14	917.14	\$917.14	8,369.91
1939 .....		450.00		15.52	31.04	31.04	77.60
1940 .....		985.00			26.82	53.64	80.46
1941 .....		1,671.70				25.96	25.96
Totals .....		\$1,198,892.12	\$1,041,158.24	\$96,363.16	\$50,162.34	\$1,027.78	\$1,188,711.52
Amount disallowed....				5,808.26	52,066.41	93,578.16	
Amount deducted in return .....				\$102,171.42	\$102,228.75	\$94,605.94	

(b) On your return for the year 1941 you deducted the amount of \$3,836.60 under special expenses. It is held that the above amount does not constitute an allowable deduction under any section of the Internal Revenue Code.

(c) It is held that the amount of \$4,676.78 deducted by you in the year 1941 as a bad debt of Grossman and Joseph is not an allowable deduction for the reason that it has not been established that a bona fide debt existed or that such alleged debt became worthless in 1941 within the meaning of section 23(k) of the Internal Revenue Code as amended.

(d) It is held that the following amounts of interest receivable on notes and accounts, which were accrued on your books in 1941, constitute taxable income within the meaning of section 22 of the Internal Revenue Code.

Belle Fox.....	680.00
Fox Chicago Realty Corporation.....	14,349.56
Kammerman and Witkin.....	450.00

(e) It is determined that the net operating loss deduction claimed by you as a deduction on your return for the year 1941 in the amount of \$163,202.50, is allowable to the extent of \$39,100.79, and the excess amount of \$124,101.71 is accordingly disallowed.

The allowable amount of \$39,100.79 represents the amount of the net operating loss carry-over deter-

mined for the year 1939 reduced by the net income determined for the year 1940, as follows: [9]

Year 1939	
Net loss as reported in your return.....	\$87,952.67
Unallowable deductions and additional income:	
(A) Depreciation disallowed.....	\$ 5,808.26
(B) New York office expense disallowed .....	11,161.88
(C) Special expense disallowed.....	1,637.50
(D) Interest income understated..	12,417.24
	<hr/>
Net loss adjusted.....	\$56,927.79
Net loss carry-over determined.....	\$56,927.79

### Explanation of Adjustments

(A) See adjustment (a) above for explanation of this adjustment.

(B) On your return for the year 1939 you deducted the amount of \$11,161.88 under New York office expenses. It is held that this deduction is not allowable under any section of the Internal Revenue Code.

(C) On your return for the year 1939 you deducted \$1,637.50 under special expenses. It is held that the above amount does not constitute an allowable deduction under any section of the Internal Revenue Code.

(D) It is held that the following amounts of interest receivable on notes and accounts, accrued on your books in 1939, constitute taxable income within the meaning of section 22 of the Internal Revenue Code:

Belle Fox.....	680.00
Fox Chicago Realty Corporation.....	10,513.24
Kammerman and Witkin.....	450.00

It is held also that the amount of \$774.00 received

from John F. Huber on his note dated September 1, 1939, which amount you credited to Eva Fox, constitutes your income.

## Year 1940

Net loss as disclosed by return.....		\$163,282.50
Unallowable deductions and additional income:		
(AA) Depreciation disallowed.....	\$52,066.41	
(BB) New York office expense disallowed .....	1,574.17	
(CC) Special expense disallowed..	1,583.71	
(DD) Interest income understated	12,355.54	
(EE) Bad debt disallowed.....	27,800.00	
(FF) Net operating loss deduction disallowed .....	87,952.67	183,332.50
Total .....		\$20,050.00
Additional deduction:		
(GG) Capital stock tax.....		2,223.00
Net income adjusted (before deduction of net loss carry-over from 1939).....		\$17,827.00

## Explanation of Adjustments

(AA) See adjustment (a) above for explanation of this adjustment.

(BB) On your return for the year 1940 you deducted the amount of \$1,574.17 under New York office expenses. It is held that this deduction is not allowable under any section of the Internal Revenue Code.

(CC) On your return for the year 1940 you deduction \$1,583.71 under special expenses. It is held that the above amount does not constitute an allowable deduction under any section of the Internal Revenue Code.

(DD) It is held that the following amounts of



interest receivable on notes and accounts, accrued on your books in 1940, constitute taxable income within the meaning of section 22 of the Internal Revenue Code:

Belle Fox.....	680.00
Fox Chicago Realty Corporation.....	10,595.54
Kammerman & Witkin.....	450.00

It is held also that the amount of \$630.00 received from John F. Huber on his note dated September 1, 1938, which amount you credited to Eva Fox constitutes your income.

(EE) It is held that the amount of \$27,800.00 deducted by you in the year 1940 as a bad debt of Mrs. Eva Fox and/or the W. F. Transportation Company is not an allowable deduction for the reason that it has not been established that a bona fide debt existed or that such alleged debt became worthless in 1940 within the meaning of section 23(k) of the Internal Revenue Code.

(FF) The 1939 loss carry-over is eliminated for the purpose of determining 1940 income or loss.

(GG) The deduction allowable for capital stock tax accrued in 1940 is \$2,500.00 in lieu of \$277.00 claimed in your return for that year.

#### Summary

1939 net loss carry-over.....	\$56,927.79
1940 net income.....	17,827.00

---

Net operating loss deduction determined.....\$39,100.79

(f) The deduction allowable for capital stock tax accrued in 1941 is \$4,062.50, in lieu of \$2,500.00 claimed in your return for that year. [11]



Computation of Declared Value Excess Profits Tax

Net income.....	\$232,989.07
Less: 10% of \$2,000,000.00, value of capital stock as declared in your capital stock tax return for the year ended June 30, 1941 .....	200,000.00
Net income subject to declared value excess profits tax.....	32,989.07
Declared value excess profits tax: 6.6% of \$32,989.07.....	\$ 2,177.28
Correct declared value excess profits tax liability.....	2,177.28
Declared value excess profits tax as- sessed: Original, account No. NC854087..	None
Deficiency of declared value excess profits tax.....	\$ 2,177.28

Computation of Income Tax

Net income.....	\$232,989.07
Less: Declared value excess profits tax .....	2,177.28
Normal tax net income.....	\$230,811.79
Surtax net income.....	230,811.79
Income tax:	
Normal tax:	
24% of \$230,811.79.....	55,394.83
Surtax:	
6% of \$25,000.00.....	1,500.00
7% of \$205,811.79.....	14,406.83
Correct income tax liability.....	\$ 71,301.66
Income tax assessed: Original, account No. NC854087	None
Deficiency of income tax.....	\$ 71,301.66

[Title of Tax Court and Cause.]

## ANSWER TO AMENDED PETITION

Comes now the Commissioner of Internal Revenue by his Attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the amended petition filed herein admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the amended petition.

2. Admits the allegations contained in paragraph 2 of the amended petition.

3. Admits that the taxes in controversy are income and declared-value excess-profits taxes for the year 1941, but denies the remainder of paragraph 3 of the amended petition.

4(1) to (7), inclusive. Denies that the Commissioner erred as alleged in subparagraphs (1) to (7), inclusive, of paragraph 4 of the amended petition.

5(1)(a); (1)(b); (1)(c); (2)(a); and (2)(b). Denies all of the allegations contained in subparagraphs (1)(a), (1)(b), (1)(c), (2)(a), and (2)(b) of paragraph 5 of the amended petition.

5(3)(a). Admits the allegations contained in subparagraph (3)(a) of paragraph 5 of the amended petition. [13]

5(3)(b) and (4)(a). Denies all of the allegations contained in subparagraphs (3)(b) and (4)(a) of paragraph 5 of the amended petition.

5(4)(b). Admits the allegations contained in subparagraph (4)(b) of paragraph 5 of the amended petition.

5(5)(a) and (5)(b). Denies all of the allegations contained in subparagraphs (5)(a) and (5)(b) of paragraph 5 of the amended petition.

5(5)(c). Admits the allegations contained in subparagraph (5)(c) of paragraph 5 of the amended petition.

5(6) and (7). Admits that the respondent allowed a net operating loss deduction for the year 1941 in the amount of \$39,100.79. Denies all other allegations contained in subparagraphs (6) and (7) of paragraph 5 of the amended petition.

Denies generally and specifically each and every allegation contained in the amended petition not hereinbefore expressly admitted, qualified, or denied.

Wherefore, it is prayed that the petitioner's appeal be denied.

/s/ J. P. WENCHEL, PAB

Chief Counsel, Bureau of  
Internal Revenue.

Of Counsel:

PHILIP A. BAYER,  
Division Counsel,

E. M. WOOLF,  
Special Attorney,  
Bureau of Internal Revenue.

Received and filed Nov. 18, 1946. [14]

[Title of Tax Court and Cause.]

### STIPULATION

It is hereby stipulated and agreed by and between the parties hereto through their respective attorneys, that for the purpose of trial and decision, the following statements are true, without prejudice to the right of either party to object to the materiality or relevance of any stipulated facts or to introduce other and further evidence not inconsistent therewith.

1. The petitioner is a Delaware corporation with principal office at 665 North Robertson Boulevard, Los Angeles, California.

2. The notice of deficiency attached to the petition was mailed to petitioner on February 27, 1945.

3. On July 12, 1929, a proposal signed by H. L. Clarke was made to the petitioner, a copy of which is attached and made a part hereof, marked Exhibit 1.

4. Said proposal was accepted by petitioner by resolution adopted by the Board of Directors at a meeting held on July 16, 1929, a copy of the minutes of such meeting is attached hereto and marked Exhibit 2.

5. H. L. Clarke caused to be delivered to petitioner all the properties, business and assets of the Mitchell Camera Company, a California corporation, referred to in the proposal dated July 12, 1929.

6. Copies of certain instruments of transfer attached and made a part hereof, marked respectively:

Exhibit 3. Deed to Lot 7, Tract 5274;

Exhibit 4. Deed to Lots 36 and 38 of Winnetka Tract and Lots 7 and 8 of Tract 3585;

Exhibit 5. Assignment of Entire Interest in Letters Patent;

Exhibit 6. Assignment of an Undivided Two-Thirds Interest in Invention and Patent Application Therefor;

Exhibit 7. Assignment of Entire Interest in Inventions before the Issuance of Letters Patent.

7. The fair market value of the net tangible property so acquired by the petitioner from or through H. L. Clarke was \$239,821.05.

8. The respondent in computing the deficiency determined the basis of patents, applications for patents and inventions acquired by petitioner as aforesaid to be \$1,180,157.59. The respondent allowed depreciation on said patents in the sums of \$95,430.50 for the year 1939, \$49,187.34 for the year 1940 and none for the year 1941, arriving at the said allowance for the year 1939 by spreading the basis over the average life of the patents, namely 12.3666 years.

9. A list of the patents, together with dates of issuance and expiration dates is attached and marked Exhibit 8.

10. The certificate of incorporation of the petitioner was filed on July 12, 1929, in the State of Delaware. Paragraph Tenth and subparagraph (7) thereto read as shown in Exhibit 9, attached.

11. Respondent's allocation of basis of patents was based on the price of \$1,475,000.00 paid by H. L. Clarke to the stockholders of the Mitchell Camera Company, a California corporation, for all the properties, business and assets of the Mitchell Camera Company of California, under a contract dated June 6, 1929, a copy of which is attached, marked Exhibit 10.

12. For the years 1939, 1940 and 1941 the petitioner deducted on its returns as ordinary and necessary expenses the following amounts designated as "special expenses."

1939.....	\$1,637.49
1940.....	1,583.71
1941.....	3,836.61

The respondent in computing the deficiency disallowed the said deductions.

13. For the years 1939 and 1940 the petitioner deducted on its returns as ordinary and necessary



expenses the following amounts designated as "New York office expenses" in the following amounts:

1939.....\$11,161.88

1940..... 1,574.17

The respondent in computing the deficiency disallowed the said deductions.

14. It is further stipulated and agreed that the amount of the net operating loss carry-over from 1939 and 1940 to the taxable year 1941 may be left for settlement under rule 50 of the Rules of Practice after the decision of the court on the other issues.

/s/ HARRY FRIEDMAN,  
Attorney for Petitioner.

/s/ J. P. WENCHEL, PAB  
Chief Counsel, Bureau of  
Internal Revenue.

Filed Oct. 22, 1946. [17]

The Tax Court of the United States

Docket No. 8058

MITCHELL CAMERA CORPORATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On the record held:

1. Petitioner has failed to establish error in the basis used by respondent in determining depreciation on its patents.
2. The amounts deductible as ordinary and necessary business expenses determined.

Harry Friedman, Esq., for the petitioner.

E. M. Woolf, Esq., for the respondent. [18]

MEMORANDUM FINDINGS OF FACT  
AND OPINION

Leech, Judge:

Respondent determined deficiencies in income and declared value excess-profits taxes of petitioner for the year 1941 in the amounts of \$71,301.66 and \$2,177.28, respectively. The determination of the correct net taxable income of petitioner for this year requires the ascertainment of the correct net income of petitioner for the calendar years 1939 and 1940 because of carry-over net losses claimed by it



for those years. The parties agree that upon the determination of that income for 1939 and 1940 the amounts of the carry-over from each year will be determined under Rule 50.

The issues are whether respondent erred (a) in fixing the basis of patents acquired at date of organization of petitioner as \$1,180,157.59 for purposes of computing depreciation, (b) in determining the accumulated reserve for depreciation on such patents to be \$1,035,539.75 as of December 31, 1938, (c) in computing depreciation on such patents during the taxable years 1939, 1940, and 1941, based on a composite average life of 12.3666 years from July 27, 1929, date of acquisition by petitioner, (d) in disallowing New York office expenses in the amounts of \$11,161.88 and \$1,574.17 for the years 1939 and 1940, respectively, and (e) in disallowing "Special Expenses" in the amounts of \$1,637.49, \$1,583.71, and \$3,836.61 for the taxable years 1939, 1940, and 1941, respectively.

Two issues, (1) the disallowance by respondent of alleged worthless debts of \$27,800 and \$4,676.78 in the years 1940 and 1941, respectively, and (2) the inclusion in income for the years 1939, 1940, and 1941 of interest in the respective amounts of \$12,417.24, \$12,355.54, and \$15,479.56, were conceded by petitioner at the hearing. These adjustments will be reflected in the recomputation under Rule 50.

Certain of the pertinent facts were stipulated by the parties and are so found. Such facts in our findings of fact as are not included among those stipulated we find upon the testimony and exhibits.

## Findings of Fact

The petitioner is a Delaware corporation organized on July 12, 1929, with principal office at Los Angeles, California. The return for the year here involved was filed with the collector for the sixth district of California.

Mitchell Camera Company of California (hereinafter referred to as "Mitchell of California") for a number of years prior to 1929 was engaged in the business of manufacturing professional motion-picture cameras and accessories for the large motion-picture studios in California. All of its business was in patented products manufactured under patents owned by it. In 1927 the introduction of "sound" motion pictures revolutionized the motion-picture industry and Mitchell of California became the sole supplier of cameras for the major motion-picture studios. This was due to the fact that under its patents were produced cameras relatively noiseless in comparison with those of its competitors. Because of the patented features of the Mitchell camera, it was practically impossible to use any other camera in the production of "sound" motion pictures, and the demand for Mitchell cameras increased greatly, resulting in a large backlog of incompleated orders in 1929. In that year the stock of Mitchell of California was owned two-thirds by Henry F. Boeger, who was its president, and one-third by George A. Mitchell, who was its secretary. [20]

Prior to May 1929, Harley L. Clarke, not then financially interested in Mitchell of California, be-

came interested in acquiring its business and assets. In 1929 William Fox was president of the Fox Film Corporation and of Fox Theatres Corporation, and was otherwise generally engaged in the motion picture business. Fox had been president of both corporations since their organization, the film corporation having been organized in 1915 and the theatres corporation in 1925. William Fox is now general manager of petitioner. His family now controls the stock of petitioner through ownership of stock in All Continent Corporation, a holding company.

The petitioner's capital upon organization consisted of 30,000 shares of common stock, no-par value. Grandeur, Incorporated (hereinafter referred to as "Grandeur"), purchased the entire capital stock of petitioner "as of July 1, 1929" for the stated sum of \$3,100,000, under circumstances hereinafter described.

The salient facts leading to the organization of the petitioner and its acquisition of the patents involved are set out chronologically as follows:

On May 24, 1929, Harley L. Clarke addressed a letter to William Fox, which letter is signed "Accepted, William Fox." This letter confirms an agreement between Clarke and Fox. Clarke agrees to cause to be organized a corporation to be known as Grandeur, Incorporated, the chief object of which shall be the purchase, sale, lease, and/or license of motion-picture projectors, cameras, and/or equipment or devices to be used in connection with motion-picture projectors. Clarke agreed "to cause

a subscription to be made for one-half of such capital stock" and Fox agreed to subscribe for the other one-half at a cost to each of \$250,000 in cash. On this same [21] day, a second letter was addressed to William Fox by H. L. Clarke, and was signed by Fox as approving and acknowledging his understanding. It reads as follows:

With reference to agreement entered into between us, today, concerning the wide film situation, this will confirm our understanding that after Grandeur, Inc., has been duly organized and its business affairs in operation, out of the first profits earned and before any dividends shall have been paid, you shall be reimburse in the sum of One Million (\$1,000,000) Dollars, and I shall be reimbursed in the sum of Five Hundred Thousand (\$500,000) Dollars for expenditures, labor, overhead, and services for research work in the development of the wide film art.

Grandeur, Inc., shall cause to be created and delivered to each of us a note or other form of acknowledgment or indebtedness suitable to our respective counsel, evidencing the foregoing arrangements.

On the next day, May 25, 1929, H. L. Clarke addressed a letter to William Fox, which is signed by Fox "Approved and agreed as to our understanding." This letter reads in part:

I am now negotiating for the purchase of the Mitchell Camera Co. This purchase shall

be for the benefit of a corporation to be organized by us, one half of the stock of which is to be owned by each of us. This corporation shall be either independently operated by us or shall be a wholly owned subsidiary of Grandeur, Inc., as shall be mutually agreed upon between our respective counsel.

On June 6, 1929, a contract was executed by and between H. F. Boeger and George A. Mitchell, called the "sellers," and H. L. Clarke, called the "buyer." The terms of this agreement provide in part as follows:

\* \* \* \* \*

1. The sellers agreed to sell or caused to be sold and the buyer agrees to purchase or cause to be purchased, as hereinafter provided, all of the property, business and assets of every kind and nature of the Mitchell Camera Co., a California corporation, hereinafter sometimes referred to as the corporation, including in such property, business and assets, furniture, fixtures, jigs, dies, tools, patterns, machinery, merchandise on hand, claims, insurance, securities, choses in action, [22] contracts agreements, leases, leasehold interests, licenses, trade marks, trade names, trade rights, brands, patents, application for patents, patent rights, also all cash and accounts receivable received by or becoming due to the corporation after June 30, 1929, and the good will of the business of the corporation or a similar name by or in connection with a corporation to be organized by the buyer to carry on a business



similar to that carried on by the corporation. The sellers also agree to cause to be conveyed to the buyer free and clear of all liens, claims and encumbrances the real estate and improvements being constructed thereon, situated in West Hollywood, county of Los Angeles, State of California, more particularly hereinafter described, being the proposed new manufacturing plant, offices and administration building of the corporation, said improvements to be fully completed in accordance with the existing plans and specifications relating thereto, with equipment and machinery to be installed therein.

\* \* \* \* \*

2. The sellers hereby represent and warrant that the corporation now owns or will acquire all letters patent under which it manufactures its products, said patents to be included in the assets to be sold to the buyer.

3. The purchase price of said property, business, and assets shall be the sum of \$1,475,000, payable as herein provided.

4. The buyer shall forthwith deposit with Continental Illinois Bank & Trust Co., Chicago, Ill., the sum of \$100,000, which said sum shall be held in escrow by said bank and applied on the purchase price as herein provided.

(a) The buyer shall forthwith proceed to cause to be organized a corporation to acquire the assets, business, and property of the corporation (hereinabove described) for conven-

ience hereinafter called the "New Corporation." The details of the organization of the corporation and the charter provisions shall be subject to the approval of counsel of the sellers and the buyer, said organization to be completed on or before July 1, 1929. The corporation shall have an authorized issue of preferred [23] stock in the amount of \$1,000,000, consisting of 10,000 shares of the par value of \$100 per share, said preferred stock to be cumulative as to dividends in the amount of 7 per cent per annum. Said preferred stock shall be fully paid and non-assessable. The charter of the new corporation shall contain certain restrictions on corporate action as set forth in Schedule A, annexed hereto and made a part hereof.

(b) On or before September 1, 1929, the buyer shall cause to be deposited with said Continental Illinois Bank & Trust Co. an additional sum of \$375,000, and 10,000 shares of the preferred stock of the new corporation, together with an agreement by the new corporation and H. L. Clarke jointly and severally to purchase from the seller said 10,000 shares of preferred stock of said new corporation at the par value thereof, \$100 per share, plus accrued dividends thereon at the rate of 7 per cent per annum, to be taken up and paid for as follows:

\* \* \* \* \*

6. It is further agreed that the sellers shall, contemporaneously with the consummation of the pur-

chase hereunder, cause to be executed a contract or contracts with the new corporation by which the sellers shall obligate themselves for a period of 5 years after the consummation of such purchase not to engage or to become interested, directly or indirectly, as an individual, partner, or stockholder, director or officer or employee in or to any motion-picture camera business, other than with the buyer or the new corporation.

7. The sellers and each of them further agree that at the request of the buyer they shall become employed by the new corporation in the same capacities as they now serve with the corporation for a period of at least 1 year and at a salary for each of them of \$25,000 per annum, payable monthly, beginning July 1, 1929.

\* \* \* \* \*

On June 13, 1929, Grandeur was incorporated under the laws of New York State. Capital was represented by 100,000 shares common stock, no-par value. One-half of its stock was acquired by William Fox and one-half by H. L. Clarke interests, for a stated consideration of \$4,000,000, under circumstances hereinafter described. [24]

On June 24, 1929, a contract was executed between Grandeur, as licensor (referred to therein as Grandeur), and Fox Theatres Corporation, as licensee (referred to therein as Fox). The relevant terms are as follows:

1. (a) Grandeur hereby grants to Fox a non-exclusive, non-assignable license to use in the



theatres owned, controlled and/or operated by Fox, Fox Films Corporation and their respective subsidiary and/or affiliated companies (subject to all the terms, conditions, limitations and agreements herein contained) special motion picture projectors, without lamp or lamphouse, adapted for use in connection with so-called "Grandeur" films (films wider than the regular 35 M.M.) in the quantities and at the times hereafter in this agreement provided and to employ and make use of (to the extent necessarily involved in such use of said projectors) any and all United States patents and applications for United States patents, relating to said projectors or to such use thereof, which are now owned or controlled, or which may during the term of this agreement be owned or controlled by International Projector Corporation, or in respect of which International Projector Corporation has or may hereafter during the term of this agreement have the right to grant such licenses, Grandeur being the licensee of International Projector Corporation, with the right to assign such use of such patents.

(b) Grandeur agrees to install in such theatres of Fox Film Corporation and/or their subsidiary or affiliated Companies that Fox may from time to time designate, twelve (12) such special motion picture projectors, for which Fox shall pay Grandeur on installation thereof the sum of Six Thousand Dollars (\$6,000).

Grandeur agrees to supply to Fox, and Fox agrees to accept or cause to be accepted from Grandeur

under the terms provided in this Agreement, during the period commencing approximately February 1, 1930, but in any event as soon as projectors shall be ready for delivery, and ending ten (10) years thereafter, all motion picture projectors using films wider than the regular 35 M.M. that may be required or desired by Fox, Fox Films Corporation and/or their subsidiary or affiliated Companies during such period, it being the agreement of the parties hereto that Fox shall, during such period, use exclusively such projectors as are manufactured by International Projector Corporation. Where hereinafter referred to, Fox shall include not only Fox Theatres but also Fox Film Corporation and/or their subsidiary or affiliated Companies. [25]

\* \* \* \* \*

4. For each such projector in excess of the twelve (12) projectors mentioned in Paragraph 1 (b) hereof, Fox agrees to pay to Grandeur in New York Exchange an installation charge of Four Thousand Dollars (\$4,000) for each such projector, payable upon the shipment of each such projector and the further payments hereinafter provided. In the event that the established installation charge made by Grandeur for such projectors is less than Four Thousand Dollars (\$4,000) at any time during the life of this contract, Fox shall be given the benefit of any such decreased charge from the effective date thereof.

5. In addition to any other payments required to be made by Fox hereunder, Fox agrees to pay

to Grandeur throughout the term of the license hereby granted, a monthly payment of \$175.00/100 in advance. Such payments shall continue for one hundred and twenty (120) months for each projector. Such monthly payment to be made by Fox to Grandeur, however, shall never be in excess of the amount in effect as the established monthly payment at the time when such monthly payment is due. The first six machines furnished, however, shall be free from such monthly payment.

\* \* \* \* \*

8. Title to and ownership of any and all projectors at any time furnished hereunder shall remain vested in Grandeur.

\* \* \* \* \*

11. \* \* \* In the event of a default in any of the provisions of this agreement at any time during the first two (2) years of the terms of this license, the entire balance of monthly payments for the first five (5) years shall be due and payable forthwith at the option of Grandeur \* \* \*.

\* \* \* \* \*

16. These licenses to be granted hereunder in respect to each projector shall be for a term of ten (10) years from the day upon which the installation of each respective projector shall have been completed and the projector made available to Fox for use, the last term to expire five (5) years from the date of installation in 1939 of the last projector provided for in Paragraph 1 of this agreement.

On July 11, 1929, General Theatres Equipment, Inc. (hereinafter referred to as "G.T.E."), was organized for the purpose of taking over the properties of the International Projector Corporation and other properties [26] intended to be acquired. In 1929 Clarke owned "just over control" stock of G.T.E., and was an officer and controlling stockholder of International Projector Corporation that was taken over by G.T.E.

On July 12, 1929, petitioner was incorporated in the State of Delaware. Its charter contains, inter alia, the following provisions:

Tenth. The following provisions are inserted for the regulation of the business and for the conduct of the affairs of this Corporation, and in further definition, limitation and regulation of the powers of this Corporation and of its directors and stockholders: \* \* \*

(7) A director of this Corporation shall not in the absence of fraud be disqualified by his office from dealing or contracting with this Corporation either as a vendor, purchaser or otherwise, nor in the absence of fraud shall any transaction or contract of this Corporation be void or voidable or affected by reason of the fact that any director, or any firm of which any director is a member, or any corporation of which any director is an officer, director, or stockholder, is in any way interested in such transaction or contract, provided that at the meeting of the Board of Directors or of a

committee thereof having authority in the premises, authorizing or confirming said contract or transaction, the interest of such director, firm or corporation is disclosed or made known and there shall be present quorum of the Board of Directors or of the directors constituting such committee, and such contract or transaction shall be approved by a majority of such quorum, which majority shall consist of directors not so interested or connected. Nor shall any director be liable to account to this Corporation for any profit realized by him from or through any such transaction or contract of this Corporation ratified or approved as aforesaid, by reason of the fact that he or any firm of which he is a member, or any corporation of which he is a stockholder, director or officer was interested in such transaction or contract. Directors so interested may be counted when present at meetings of the Board of Directors or of such committee for the purpose of determining the existence of a quorum. Any contract, transaction or act of this Corporation or of the Board of Directors or of any committee thereof which shall be ratified by a majority in interest of a quorum of the stockholders having voting power at any annual meeting or any special meeting called for such purpose, shall be as valid and as binding as though ratified by every stockholder of this Corporation. \* \* \* [27]



On the same date, a proposal signed by H. L. Clarke was made to petitioner to transfer to it all the properties, business, and assets of Mitchell of California for a stated consideration of \$3,100,000 in cash. This proposal refers to a balance sheet annexed thereto, marked Exhibit "A" and made a part thereof. This balance sheet shows a net worth (capital stock and surplus) of \$330,480.50 for Mitchell of California, as of December 31, 1928. Clarke's proposal contains a sentence reading:

\* \* \* The undersigned represents to you that at the date of the acquisition by you of said properties, business and assets of said Mitchell Camera Company your financial condition will be at least as good as is reflected on the pro forma balance sheet annexed hereto, marked Exhibit "A," and made a part hereof.

At a special meeting of the board of directors of petitioner held July 16, 1929, the president (H. L. Clarke) occupied the chair. Henry F. Boeger, one of the sellers of Mitchell of California, was elected a vice-president. The chairman (H. L. Clarke) stated it was advisable to open a bank account in the Chase National Bank of the City of New York. Thereupon, a resolution was adopted, authorizing its officers and agents to deposit funds of petitioner in Chase National Bank of the City of New York, and to withdraw the same upon checks or instruments, drawn against the account "and made or signed by H. L. Clarke, President, or signed by S. R. Burns, Vice President, and countersigned by

W. C. Michel, Treasurer.” The directors further resolved that Chase National Bank be authorized to accept, honor, cash, and pay without limit as to amount, and until written notice of revocation of the authority is actually received by said bank, all checks and other instruments for the payment of money, including all such instruments [28] “payable or endorsed to the personal order of the officer or officers or agent or agents signing on behalf of this Corporation.” At this same meeting, a resolution was adopted accepting Clarke’s July 12, 1929 proposal to sell the assets of Mitchell of California to petitioner for \$3,100,000 and authorizing its proper officers to execute all necessary documents to carry this resolution into effect.

Clarke presented to this meeting a proposal by Grandeur (of which Clarke was president) to acquire all of the capital stock of petitioner. This proposal is in the following form:

The undersigned hereby offers to purchase Thirty Thousand (30,000) shares of your capital stock without par value, being all of your authorized capital stock, for the sum of Three Million One Hundred Thousand (\$3,100,000) Dollars in cash, subject to and upon condition that your Corporation acquires all of the assets of Mitchell Camera Company, a California corporation, so that as a result of such acquisition by your Corporation and the receipt by your Corporation of such \$3,100,000 in cash



the financial condition of your Corporation will be at least as good as the financial condition of Mitchell Camera Company as shown by the latter Company's balance sheet dated December 31, 1928, a copy of which is attached hereto, marked Exhibit "A."

The Exhibit "A" balance sheet referred to is identical with the balance sheet hereinabove referred to, and shows net worth of \$330,480.50.

By appropriate resolution, the foregoing proposal of Grandeur was duly accepted by petitioner's board of directors.

The signature of H. L. Clarke is appended at the close of these minutes.

On July 27, 1929, a deed was signed by Mitchell of California, by H. F. Boeger, president, and George A. Mitchell, secretary, transferring real property in Los Angeles County, Lot 7 of Tract 5274, from that corporation direct to petitioner. Also on July 27, 1929, a deed was signed by Henry F. Boeger, [29] George A. Mitchell, and their respective wives, transferring real property in Los Angeles County, Lots 36 and 38 of the Winnetka Tract, and Lots 7 and 8 of Tract No. 3585, from those individuals direct to petitioner. Both these deeds were recorded September 3, 1929. All of this real estate constituted part of the property included in the contract of June 6, 1929, to be sold to H. L. Clarke by Boeger and Mitchell for the consideration of \$1,475,000.

On July 27, 1929, assignments of patents and applications for patents were made to petitioner as follows:

(a) Mitchell of California, as sole owner, assigned and transferred its whole right, title and interest in and to 25 patents.

(b) H. F. Boeger and George A. Mitchell transferred their two-thirds interest in an application for patent for an improvement in making composite pictures, applied for January 17, 1927, Serial No. 161,639.

(c) George A. Mitchell sold, assigned and transferred all his right, title and interest in applications for six patents enumerated therein.

In all, 30 patents and patent rights on which patents were ultimately obtained, being all the patents and patent rights belonging to Mitchell of California, were transferred to petitioner.

Under date of July 29, 1929, a letter was addressed to Continental Illinois Bank and Trust Co., Chicago, Illinois, signed by H. F. Boeger, [30] and by H. F. Boeger, as attorney in fact for George A. Mitchell. According to its terms, H. L. Clarke has theretofore deposited with the bank the contract dated June 6, 1929, under which Boeger and Mitchell were conveying to Clarke or his nominee the real property described in the contract, together with all the assets of Mitchell of California. This letter transmitted the deeds to the real property and the assignments of patents and patent applications

above referred to, together with a bill of sale covering the personal property described in the contract of June 6, 1929. The letter, in part, states:

The buyer, H. L. Clarke, has heretofore deposited with you for the undersigned the sum of \$100,000.00 and will on or about August 7, 1929, or before, deposit an additional \$1,375,000.00 for the undersigned. The above mentioned agreement, dated June 6, 1929, provides for a repurchase agreement to be executed by the buyer for the repurchase of the preferred stock therein mentioned. Since the transaction does not involve any stock this provision for the repurchase agreement will not concern you.

You are hereby instructed to collect for the undersigned from the buyer interest on the above-mentioned sum of money, to-wit: \$1,475,000.00 at the rate of seven per cent, per annum, from July 1, 1929, until paid and to hold all of said moneys until further instructions. \* \* \*

Under the terms of the June 6, 1929 contract, the purchasing group was to pay \$475,000 in cash and \$1,000,000 in preferred stock of a new corporation. Clarke notified Boeger and Mitchell he had decided to pay all cash. The agreement was consummated in cash. The \$1,475,000 was not paid to Boeger and Mitchell until the Fall of 1929.

On August 1 and 2, 1929, a series of concurrent financial transactions occurred in effectuating the acquisition by Grandeur of all the capital stock in petitioner and in consummating the acquisition by

petitioner through Clarke of all the business and assets of Mitchell of California. These transactions [31] are summarized, chronologically set forth, and separately numbered:

1. On August 1, 1929, G.T.E. received \$11,400,000 from the sale of its securities. Of this fund, \$2,000,000 was used to acquire 50,000 shares, or 50 per cent of capital stock of Grandeur, and \$3,000,000 was used to acquire J. E. McCauley Manufacturing Company, Strong Electric Company, Ashcraft Automatic Arc Company and Hall and Connolly, Inc. (hereinafter referred to as "the four lamp companies.") Clarke handled these transactions and had general direction of acquiring this one-half stock interest in Grandeur, and also of acquiring the four lamp companies on behalf of G.T.E.

2. On August 1, 1929, Clarke deposited \$5,000,000 to his credit at Chase National Bank, New York, New York, resulting in a balance in his account on that date of \$5,025,024.29.

3. On August 1, 1929, H. L. Clarke issued two checks payable to William Fox for the acquisition by Fox of the other one-half interest in Grandeur. These checks drawn on Chase National Bank, signed by H. L. Clarke, are in the respective amounts of \$1,625,000 and \$375,000, aggregating \$2,000,000, and are endorsed by Fox "For Deposit." Clarke's account at Chase National Bank discloses a withdrawal of \$2,000,000 on August 2, 1929, bearing a notation "cc" (certified check).

4. William Fox acknowledged receiving the two checks aggregating \$2,000,000 from Clarke, but Fox

testified that he gave the "Harley Clarke interests" \$2,000,000 of checks in exchange. For the two checks from Clarke, Fox by check dated August 1, 1929, paid into Grandeur \$1,950,000 toward his one-half interest in its capital stock. Prior to that date he had put up or given Clarke \$50,000 as a down payment to apply on the [32] purchase of the assets of Mitchell of California. Fox's check for \$1,950,000 is dated August 1, 1929, payable to the order of Grandeur, drawn on National City Bank of New York, and signed for William Fox by his duly authorized agents. The check certified August 2, 1929, by the National City Bank, is endorsed "For Deposit and Credit to Account of Grandeur, Inc." On the same day the Chase National Bank received payment for the account of Grandeur.

5. Clarke's account at Chase National Bank similarly discloses a withdrawal of \$1,950,000 on August 2, 1929, in addition to the withdrawal of \$2,000,000 on the same date for the checks to Fox referred to in step 3 above.

6. Under date of August 1, 1929, Grandeur issued its check, drawn on Chase National Bank, in the amount of \$3,000,000, payable to the order of "Mitchell Camera Corporation," and signed "Grandeur, Inc., by H. L. Clarke, President." This check is endorsed "For Deposit & credit to Account of Mitchell Camera Corporation," and was honored by the Chase National Bank August 2, 1929.

7. The bank account of petitioner at Chase



National Bank shows a deposit of Grandeur's check in the amount of \$3,000,000 on August 2, 1929. On the same date it shows a withdrawal of \$3,000,000, representing a check issued to Clarke, leaving no balance.

8. On August 2, 1929, H. L. Clarke's account at Chase National Bank shows a deposit of petitioner's check for \$3,000,000. This deposit is credited on the bank statement immediately prior to Clarke's withdrawals on the same date of \$2,000,000 and \$1,950,000, referred to in steps 3 and 5 above. [33]

After the consummation of these check transactions on August 1 and 2, 1929, G.T.E. owned one-half of the capital stock of Grandeur, at a cost of \$2,000,000, and William Fox owned the other half at no cost to him. Grandeur, in turn, owned and continued to own all the capital stock of petitioner through the taxable year 1941.

The consolidated statements of assets and liabilities as at July 1, 1929, and December 31, 1929, attached to the 1929 consolidated income tax return filed by Grandeur and petitioner, disclose that Grandeur had \$4,000,000 capital stock outstanding, represented by 100,000 shares common stock—no-par value, and that Grandeur owned the entire capital stock of petitioner, carried at a book value of \$3,100,000. The July 1, 1929 statement of assets and liabilities discloses that Grandeur retained \$900,000 undisbursed cash to be used as working capital.

The amount of \$1,475,000 paid to acquire the business and assets of Mitchell of California was

obtained by Clarke from G.T.E. out of its \$11,400,000 fund. Clarke had deposited \$100,000 on or before July 1, 1929, under the agreement of June 6, 1929, of which Fox had advanced \$50,000. Fox was later reimbursed for his \$50,000 advance by the check for \$2,000,000 dated August 1, 1929, received in exchange for his \$1,950,000 check. Clarke paid the balance due under the June 6, 1929 contract, \$1,375,000 plus interest, \$14,627.58, total \$1,389,627.58, on August 24, 1929.

Out of G.T.E.'s \$11,400,000 fund, \$3,000,000 was paid to Clarke to acquire the four lamp companies. To acquire these companies, Clarke paid an aggregate of \$1,757,422.93, the individual amounts paid being as follows: [34]

J. E. McCauley Manufacturing Co.....	\$1,131,422.93
Strong Electric Company.....	316,000.00
Ashcraft Automatic Arc. Co.....	150,000.00
Hall and Connolly, Inc.....	160,000.00
<hr/>	
Total .....	\$1,757,422.93

In addition to the two checks aggregating \$2,000,000 which Clarke gave Fox, Clarke also gave Fox 25,000 shares of G.T.E. stock, at \$30 per share, with a repurchase agreement, valued at \$750,000. G.T.E. had approximately 2,000,000 shares of stock outstanding.

Grandeur and petitioner filed a consolidated income tax return for the period July 1 to December 31, 1929, reporting a consolidated net income of \$233,796.07 and a tax liability of \$25,717.57. This return is sworn to by H. L. Clarke, president. A



notation attached thereto reads: "Grandeur, Inc., purchased the entire capital stock of Mitchell Camera Corporation as of July 1, 1929." The statement of assets and liabilities for petitioner "as of July 1, 1929," includes net tangible assets \$239,821.05, good will \$2,805,157.59, patents \$55,021.36, and capital stock outstanding \$3,100,000, and is as follows:

Assets		Liabilities	
Land .....	\$ 35,535.40	Capital stock	
Buildings .....	73,938.48	represented by	
Machinery and		30,000 shares	
Equipment ....	91,008.70	common — no	
Land held for		par value.....	\$3,100,000.00
sale .....	2,050.32	Reserve for de-	
Patents .....	55,021.36	preciation .....	12,760.82
Good Will.....	2,805,157.59	Accounts pay-	
Accounts		able .....	2,815.00
receivable .....	2,815.00	Accrued payroll..	847.80
Inventory .....	50,896.77		
Totals .....	\$3,116,423.62		\$3,116,423.62

The December 31, 1929 statement of assets and liabilities of petitioner attached to the 1929 return discloses the values of good will and patents reported at \$2,805,157.59 and \$52,961.28, respectively. A deduction for depreciation on all assets of \$7,765.94 was claimed by petitioner in the return for the period July 1 to December 31, 1929. No adjustment of the depreciation claimed in the return was made by the respondent.

The 1930 consolidated income tax return of Grandeur and petitioner reported a net income of \$84,213.47. Patents were reported at a net value

of \$52,961.28 at the beginning of the year; and at a value of \$92,768.11 less a reserve for depreciation of \$42,028.91, or a net value of \$50,739.20 at the end of the year. A value of \$2,805,157.59 was reported for "Good Will, Franchise Rights, and Going Concern Value" at both the beginning and end of the year. The deduction for depreciation of patents claimed on the return was \$5,347.98 (approximately 1/17th of average basis of \$92,518.61).

The 1931 consolidated income tax return of Grandeur and petitioner reported patents at a value of \$92,768.11 less a reserve for accumulated depreciation of \$42,028.91, or a net value of \$50,739.20 at the beginning of the year, and at a value of \$94,833.11 less a reserve for depreciation of \$47,514.16, or a net value of \$47,318.95 at the end of the year. A value of \$2,805,157.59 was reported for "Good Will, Franchise Rights, and Going Concern Value" at both the beginning and end of the taxable year. The deduction for depreciation of patents claimed on the return was \$5,485.25 (approximately 1/17th of \$94,833.11).

The Revenue Agent in reports dated March 3, 1932, and April 10, 1933, proposed deficiencies based on revisions of consolidated net incomes reported for [37] 1930 and 1931, respectively, on issues other than depreciation of patents. These deficiencies and net incomes were subsequently redetermined by allowances to petitioner of additional depreciation of \$90,082.52 for 1930, and \$89,945.25 for 1931, on the patents acquired at organization, the revised basis, life, amortization allowable, and additional patent

depreciation allowances being computed in Revenue Agent's letter to Grandeur, dated January 5, 1934, as follows:

Total paid into Grandeur, Inc., by Harley Clark and William Fox..	\$ 4,000,000.00	
Paid by Grandeur for net assets of Mitchell Camera Co. of California .....	3,100,000.00	
Balance — Cash remaining in Grandeur .....	\$ 900,000.00	
Cost of assets—Mitchell Camera Co. of California as above.....	\$ 3,100,000.00	
Net assets claimed other than good will .....	294,842.41	
Good will and intangibles.....	\$ 2,805,157.59	
Actual value paid by Harley Clark [sic] for total assets per letter to "Continental Illinois Bank and Trust Co.," Chicago, Ill. Photo-static copy with 1930 revised schedules .....	\$ 1,475,000.00	
Less Net assets other than good will .....	294,842.41	
Considered as value of patents Life 12.36666 years—amortization allowable .....	\$ 1,180,157.59	
	\$ 95,430.50	
	Year 1930	Year 1931
Amortization allowable (above).....	\$ 95,430.50	\$ 95,430.50
Amortization allowable per return	5,347.98	5,485.25
Additional .....	\$ 90,082.52	\$ 89,945.25

Grandeur and petitioner agreed to revised deficiencies computed on the basis of the foregoing additional depreciation of patent allowances, evidenced by the filing of a waiver of restrictions on

assessment and collection of deficiencies in taxes amounting to \$4,075.84 for 1930, and \$471.17 for 1931. This agreement, executed on Treasury Department Form 870, dated December 22, 1933, is signed for Grandeur and Affiliated Companies by "William Fox, Pres." and was accepted by Bureau letter dated April 19, 1934.

Prior to the closing of the returns for the taxable years 1930 and 1931, Grandeur and petitioner had filed a consolidated return for 1932 reporting a net loss of \$102,819.84. In statements of assets and liabilities attached to this return, the value of good will of petitioner was reported at \$1,555,157.59 as at the beginning and end of the year, and the value of patents was reported at \$1,344,833.11 as the beginning, and at \$1,345,909.91 as at the end of the year. These figures reflected a write-down of \$1,250,000 in the good will account and an identical write-up of that amount in the patent account, compared with 1931 closing balances as follows:

	Good Will	Patents
Opening 1932 balances.....	\$1,555,157.59	\$1,344,833.11
Closing 1931 balances.....	2,805,157.59	94,833.11
	<hr/>	<hr/>
(Decrease) or increase.....	(\$1,250,000.00)	\$1,250,000.00

Petitioner reported details for patents in the depreciation schedule on its 1932 return as follows:

Depreciable patent value.....	\$1,345,909.91
Depreciation on patents allowed (or allowable) in previous years.....	\$ 291,787.71
Depreciation deducted taxable years.....	\$ 106,676.73

The depreciation deducted by the petitioner on its 1932 return was not changed by the respondent.

In statements of assets and liabilities attached to its 1933, 1934, 1935, 1936, 1937, and 1938 income tax returns, petitioner reported the following values of good will and patents as at the beginning and end of each taxable year:

	Goodwill	Patents
January 1, 1933.....	\$1,555,157.59	\$1,345,909.91
December 31, 1933.....	1,555,157.59	1,350,363.26
December 31, 1934.....	1,555,157.59	1,353,084.58
December 31, 1935.....	1,555,157.59	1,353,816.58
December 31, 1936.....	1,555,157.59	1,354,146.58
December 31, 1937.....	1,555,157.59	1,354,636.94
December 31, 1938.....	1,555,157.59	1,354,710.04

For the taxable years 1933 through 1938, inclusive, the following depreciable patent values, depreciation on patents allowed (or allowable) in previous years, deductions for depreciation of patents, and net losses were reported on income tax returns filed by petitioner:

	Depreciable Patent Values	Depreciation allowed (or allowable) Previous Years	Depreciation Taxable Year	Net Losses Reported
1933 .....	\$1,350,363.26	\$398,463.44	\$106,885.24	(\$93,726.56)
1934 .....	1,350,363.26	505,348.68	107,068.24	( 78,281.83)
1935 .....	1,350,363.26	612,416.92	107,139.43	( 65,964.83)
1936 .....	1,354,146.58	719,556.35	107,175.31	( 3,619.65)
1937 .....	1,354,636.94	826,731.66	107,203.46	( 32,630.05)
1938 .....	1,354,710.04	933,935.12	107,223.12	( 17,495.03)
Total .....			\$642,694.80	

The depreciation deductions claimed by the petitioner for 1933 to 1938, inclusive, were not changed by the respondent.

In statements of assets and liabilities attached to its 1939, 1940 and 1941 income tax returns petitioner



reported the following values of good will and patents at the beginning and end of each taxable year:

	Goodwill	Patents
January 1, 1939.....	\$1,555,157.59	\$1,354,710.04
December 31, 1939.....	1,555,157.59	1,355,160.04
<hr/>		
January 1, 1940.....	\$1,555,157.59	\$1,355,160.04
December 31, 1940.....	1,555,157.59	1,356,145.04
<hr/>		
January 1, 1941.....	None	\$ 105,895.54
December 31, 1941.....	\$1,680,021.36	1,198,892.12

For the taxable years 1939, 1940, and 1941, the following depreciable patent values, depreciation on patents allowed (or allowable) in previous years, deductions for depreciation of patents, and net losses were reported in returns filed by petitioner:

	Depreciable Patent Values	Depreciation allowed (or allowable) Previous Years	Depreciation Taxable Year	Net Losses Reported
1939 ....	\$1,355,160.04	\$1,041,158.24	\$102,171.42	(\$87,952.61)
1940 ....	1,355,160.04	1,143,329.66	102,228.75	(163,282.50)
1941 ....	1,198,892.12	1,097,000.46	94,605.94	( 7,121.24)

In the notice of deficiency the respondent determined that the basis for computation of allowable depreciation of the group of patents and patent applications acquired on July 27, 1929, was \$1,180,157.59; that the said amount is recoverable through depreciation allowances over the average life of the entire group of patents, namely 12.3666 years from July 27, 1929, and that for the taxable years 1939, 1940, and 1941 petitioner is entitled to deductions of [40] \$96,363.16, \$50,162.34, and \$1,027.78, respectively, as allowable depreciation of patents, computed as follows:



Patents		Depreciation				
Acquired	Cost	Allowed to 12-31-38	1939	Allowable 1940	1941	Total to 12-31-41
7/25/29 .....	\$1,180,157.59	\$1,035,539.75	\$95,430.50	\$49,187.34	None	\$1,180,157.59
Add'ns to 12/31/38..	15,627.83	5,618.49	917.14	917.14	\$917.14	8,369.91
1939 .....	450.00		15.52	31.04	31.04	77.60
1940 .....	985.00			26.82	53.64	80.46
1941 .....	1,671.70				25.96	25.96
Totals .....	\$1,198,892.12	\$1,041,158.24	\$96,363.16	\$50,162.34	\$1,027.78	\$1,188,711.52
Amount disallowed....			5,808.26	52,066.41	93,578.16	
Amount deducted in return .....			\$102,171.42	\$102,228.75	\$94,605.94	

H. F. Boeger was elected vice-president of petitioner at a meeting of the board of directors held August 2, 1929. For the year 1930 Boeger received a salary from petitioner of \$25,000. H. F. Boeger, George A. Mitchell, and William Fox were elected to the board of directors of petitioner at such meeting. These same individuals continued to serve as directors at the March 16, 1932 meeting. George A. Mitchell has continued to be employed by petitioner as engineer in charge of production and development. He was employed for a period of approximately five years from the date of incorporation at a salary of \$25,000 a year.

Messrs. Boeger and Mitchell entered into an agreement not to engage in or become interested directly or indirectly as individuals, partners, directors, officers, or employers, in any motion-picture camera business other than with the buyer, or with petitioner, for a period of five years from the date of the June 6, 1929 agreement.

During 1929 H. L. Clarke was the controlling stockholder of G.T.E.; was president of G.T.E., of Grandeur, and of petitioner.

For the taxable years 1939 and 1940, petitioner deducted on its returns as ordinary and necessary business expenses the respective amounts of \$11,161.88 and \$1,574.17 designated "New York Office Expenses," which the respondent disallowed. These expenditures constitute ordinary and necessary business expenses to the extent of \$10,255.11 for 1939 and \$1,050.65 for 1940.

Certain other expenditures made and entered on its books in 1939, 1940, and 1941, in the respective sums of \$1,637.49, \$1,583.71, and \$3,836.61, were ordinary and necessary expenses of the business.

### OPINION

The principal issue is the basis for depreciation of certain patents acquired by petitioner in 1929 upon its organization and included in the aggregate of assets, tangible and intangible, constituting all the property and going business of Mitchell of California. Respondent asserts that basis to be \$1,180,157.59, while petitioner contends for a basis of \$2,860,178.95.

We have set out in our findings the facts in connection with the sale by Mitchell of California of all of its business and its acquisition by petitioner. Briefly stated, these facts are: Clarke and Fox had been associated in some work in developing a wide film camera know as "Grandeur." On May 24, 1929 they agreed in writing that a corporation would organized under the name of Grandeur, to engage in the business of "purchase, sale, lease and/or license of motion picture projectors, cameras and/or equipment or devices to be used in connection with motion picture projectors." This company was to pay out of its first earnings \$1,000,000 to Fox and \$500,000 to Clarke as reimbursement for their "expenditures, labor, overhead, and services for research work in the development of the wide film art."

On the next day a second agreement was executed by the parties, evidencing the fact that Clarke was

negotiating for the purchase of the business of Mitchell of California. In this instrument it was agreed that the purchase, if effected by him, was to be "for the benefit of a corporation to be organized by us—either independently operated by us or shall be wholly owned subsidiary of Grandeur, Inc."

Following this, Clarke negotiated the purchase of all the assets and business of Mitchell of California for an agreed consideration of \$1,475,000. The instrument effecting the conveyances were drawn to petitioner herein, and placed in escrow. Clarke deposited \$100,000 with the escrow agent and the balance of the purchase price was to be paid upon the delivery of the deeds and assignments. The deposit was furnished equally by Fox and Clarke. It constituted, so far as this record reveals, the only personal funds of these individuals used in the course of the series of involved transactions which followed.

Clarke and Fox caused three corporations to be organized, General Theaters Equipment, otherwise here referred to as G.T.E., Grandeur, and petitioner, Mitchell Camera Corporation. Clarke was president of all three corporations with authority to act for them and disburse their funds. [43]

On July 12, 1929, the day of the incorporation of petitioner, Clarke, as an individual, made an offer to petitioner to sell it the assets and business of Mitchell of California for \$3,100,000, which offer was accepted. Nothing was done toward closing the transaction with Mitchell of California until August 1, 1929. On that date G.T.E. came into possession

of \$11,400,000 in cash, from the sale of its securities. Arrangement had been made for its acquisition of several "lamp companies," not here involved. Clarke conducted the arrangement for these acquisitions. The sum of \$2,000,000 was paid by G.T.E. into Grandeur, for one-half of the latter's capital stock. Clarke had \$5,000,000 of G.T.E. funds paid into his personal bank account, which prior thereto had a balance slightly in excess of \$25,000. Thereupon Clarke "gave" Fox a check for \$2,000,000 of these G.T.E. funds, and Fox paid this amount into Grandeur, for the remaining one-half of its capital stock. Clarke then had Grandeur give petitioner its check for \$3,100,000 of the total of \$4,000,000 standing to its credit. For this Grandeur received in return all of the capital stock of petitioner. Thereupon Clarke had petitioner give its check for \$3,100,000 to him personally which he used to reimburse himself and Fox for their \$100,000 deposit and to pay the balance of \$1,375,000 due Mitchell of California for its assets and business.

Included in the assets acquired from Mitchell of California were some 30 patents and patent applications upon which patents were later issued. There is no evidence that in the negotiations or at any time in connection with the transactions effecting this purchase was any amount of the total purchase price allocated as paid for these patents. Petitioner now contends that outside of certain tangible assets of Mitchell of California, having an agreed value of \$239,821.05, there was nothing of value except the patents conveyed. It insists that Mitchell of



California had no good will or other intangible asset of any value and the only thing desired or considered as having value were the patents in question. It argues that the total consideration paid by petitioner, \$3,100,000, must be accepted as paid for all of the assets acquired, and to the patents there be allocated a cost of this amount less the agreed value of other tangible assets in the sum of \$239,821.05.

The record shows this is not the first occasion an investigation has been made to determine the actual basis to petitioner for depreciation purposes of the patents acquired in this transaction.

Petitioner in its statement of assets and liabilities attached to its first return filed for the period July 1 to December 31, 1929, reported patents as having a cost basis as of December 31, 1929 of \$52,961.28, and good will as having a cost basis of \$2,805,157.59. In that return it deducted depreciation on all depreciable assets in the sum of \$7,765.94. In the return for 1930, patents were reported as having the same basis, \$52,961.28, at the beginning of the year, and \$92,768.11 less a reserve for depreciation of \$42,028.91, or a net value of \$50,739.20 as of the close of the year. A value of \$2,805,157.59 was reported for "Goodwill, Franchise rights and Going Concern value" at both the beginning and end of the year. The return for 1931 reported the same value as from the first of \$2,805,157.59 for good will, franchise rights and going concern value and the patents at a basis of \$92,768.11 less a reserve for accumulated depreciation of \$42,028.91 or a net value



of \$50,739.20. These are the respective costs for good will and patents entered on petitioner's records upon their acquisition. Thus, the assumption is not unreasonable that these values reflected its then opinion of the relative value between patents and good will to be used as the basis of allocation to each of the total amount paid for the aggregate.

In 1932, upon audit of petitioner's returns for 1930 and 1931, deficiencies were proposed for those years. A controversy arose as to the correct portion of the total contract price allocable to the patents acquired. It is significant also that this controversy took place at a period when the transactions involving the acquisition of these assets and all of the details in connection therewith were fresh in the minds of the parties. All the records made available in the present proceeding were undoubtedly available to the officers and agents of petitioner and the respondent in that investigation. Conditions making for accurate determination existed then rather than now after the lapse of years.

As a result of this investigation and the conferences between the representatives of respondent and petitioner, the amount of the total cost to be ascribed to the patents in question was fixed as the amount at which Mitchell of California sold all of its properties, namely: \$1,475,000, less \$294,842.41, which was fixed as the value of the assets other than good will and patents. The resulting figure, \$1,180,157.59, was accepted by petitioner as the basis for computing depreciation upon its patents which, it was further agreed, should be depreciated upon the

average life method and upon a life of 12.3666 years. Upon this agreed basis, the depreciation deductible by petitioner was recomputed, resulting in a depreciation allowance of \$95,430.50 for each of those years as against the deductions of slightly over \$5,000 taken on its returns by petitioner in each of the years. [46]

Following this controversy, petitioner in each of the ensuing years used the same basis for depreciation of the patents and took the benefit of the deductions computed thereon. No question was raised as to the correctness of this basis until the taxable year before us. That correctness is now attacked because of the fact that respondent in determining the deficiency for the taxable year 1941 has computed the total depreciation "allowed or allowable" in prior years on the agreed basis of \$1,185,157.59 on an average life of 12.3666 years from July 27, 1929, the date of acquisition of the patents. This computation resulted in deductions for 1939, 1940, and 1941 of \$96,363.16, \$50,162.34, and \$1,027.78 as against the deductions taken on the returns of petitioner for those years of \$102,171.42, \$102,228.75 and \$94,605.94, respectively. The basis formerly agreed upon and used during the years having been exhausted, petitioner now seeks a larger basis and a different formula.

The burden, of course, is upon petitioner to show error in the basis for depreciation used by respondent in determining the deficiency. It would require very convincing proof here that the basis reached by the parties upon their investigation of the facts

at a time when all the circumstances were fresh in their memories and thereafter used for more than 10 years was incorrect. The evidence does not convince us that such basis was not a proper one. We do not agree that the assets and business of Mitchell of California had value represented only by its patents and certain other tangible property. Rather the evidence indicates to us that there was very substantial value in the good will and going business value of that concern. We cannot reconcile the statement that at the time the assets of Mitchell of California were acquired it was realized that such company had no good will or going business value with the fact that petitioner entered on its books a total amount of \$2,805,157.59 as representing what it had paid for these intangibles. Mitchell of California was a successful corporation operating a very prosperous business. The trade recognized that this company produced the best motion-picture cameras available. At the time of acquisition it had on hand a large backlog of unfilled orders. That its name was recognized in and as having value in the trade is shown, we think, by the fact that it was taken and used by petitioner.

Clarke purchased all the business and assets of Mitchell of California for the account of petitioner for an agreed consideration of \$1,475,000. That was the amount the seller received. This was an arm's length transaction and the only one, we think, which can be so characterized. The other transactions carried out by Clarke and Fox, through the three corporations they organized, were ones in which

the individual as such dealt with himself as president of a corporation. Thus it is evident to us that the price stated in the contract of purchase by petitioner might bear little, if any, relation to what actually was paid for the assets acquired, even though the full amount was paid from the treasury of the acquiring corporation. The manner in which the transaction was consummated does not establish the fact that petitioner actually paid \$3,100,000 for the assets it acquired. This record does not convince us that the indirect method used for carrying out the transaction was not merely a means of channeling certain proceeds from the sale of securities by G.T.E. to Clarke and Fox through their control of the corporations they organized. Certainly it is not established that the difference between the purchase price paid Mitchell of California and the \$3,100,000 actually paid by Clarke to himself from the funds of petitioner was paid as consideration for the assets. We hold that petitioner has not proved that its actual cost of the assets and business of Mitchell of California was in excess of \$1,475,000. In this connection it is noted the contention is made that in addition to this amount large sums were paid as "commissions" in connection with the deals, and that these must necessarily be considered as additional cost. To whom they were paid or for what service rendered, we are not advised. These commissions are vaguely described as aggregating in amount somewhere between three hundred fifty and four hundred thousand. At a hearing before the Senate Committee on Banking and Currency,



the evidence was that \$100,000 was paid as commissions for the acquisition of not only the assets of Mitchell of California but of other corporations acquired by G.T.E. There was no showing that any part of this \$100,000 was paid in connection with the transaction here in question. We think more evidence than this is required upon which to base a finding of additional cost by reason of commissions paid. [49]

Petitioner contends that even if we find the actual cost to petitioner of the assets and business of Mitchell of California was only \$1,475,000, the computation under which the allocation of cost was originally made in the investigation in 1932 is subject to correction in one respect. It is pointed out that the amount of \$1,180,157.59 fixed by respondent as the cost of the patents was arrived at as the difference between \$1,475,000 and a value of \$294,842.41 assigned to net assets other than good will. Petitioner says it is here stipulated that the value of net tangible assets received from Mitchell of California was only \$239,281.05, and consequently a correct computation upon the basis used by the parties at that time would increase by \$55,021.36 the base then used for depreciation. This contention can not be sustained. That amount, \$294,842.41, was computed as the cost of net assets other than good will, whereas the value of \$239,821.05 which petitioner asks be substituted is the stipulated value of net tangible assets. We think the record amply demonstrates that intangible assets of substantial value exclusive of good will were received

among the assets acquired from Mitchell of California. One of these intangible assets was the agreements of the two organizers and operators of Mitchell of California not to engage in its line of business for a period of years. Another such asset was its large backlog of contracts. These might well have been worth the difference in the above two figures.

Petitioner further contends the formula used by it and by the respondent over all the years in computing allowable depreciation is incorrect. The patents in question, approximately 30 in number, had varying lives. Having been acquired as a whole, no basis existed for the allocation of an individual cost to each. Hence, the formula based on the average remaining life of the patents computed at 12.3666 years was used. It was [50] then apparent such formula would exhaust the depreciation basis of the aggregate of patents prior to the expiration of the longest-lived patent. Such formula has been consistently applied. Petitioner has taken depreciation each year upon such basis, thereby exhausting the entire basis prior to the taxable year. It now requests use of a formula approved in *Simmons Co.*, 8 B.T.A. 631. Petitioner argues that the only correct method of computing depreciation exhausts the basis ratably over the entire life of the asset and that this result is accomplished only by use of the formula approved in that case. In that case, the taxpayer had purchased 113 patents in one group. We there approved a deduction for depreciation for each year of that portion of the total cost which bore the same relation to such total cost as the life



of the patents which expired in each year bore to the total unexpired life of the group on the date of acquisition. It is urged our decision there must be construed as a disapproval of the average life formula here used. However, in the Simmons case, no dispute existed between the parties as to the formula used. We merely held that the agreed formula there used would be accepted since it appeared to result in that which the statute directed, namely: "reasonable allowance for depreciation."

The statute does not provide a formula. It appears to us that the use of the average life formula in the instant case results in a reasonable allowance. That was the view of the parties in adopting and using it consistently over the years. Petitioner in each such year has been allowed the deduction for depreciation thus computed. We have recognized [51] such formula as proper in other cases. Union Metals Mfg. Co., 4 B.T.A. 287; Prophylactic Brush Co., 25 B.T.A. 676; Syracuse Food Products Corp., 21 B.T.A. 865. Having taken this depreciation, petitioner cannot now, after the exhaustion of its basis, recompute its allowances according to another formula. *Virginian Hotel Corp. v. Helvering*, 319 U. S. 523.

In determining the deficiencies respondent disallowed certain deductions denoted "New York Office Expenses" for 1939 and 1940 and "Special Expenses" for 1939, 1940, and 1941. We have found the correct amounts of these items for each year and that they were ordinary and necessary business expenses. It follows that such amounts are deduc-

tible. Section 23, I.R.C. The total of these expense deductions claimed for 1939 has been reduced by \$100 as constituting not an expense but a donation to the Hebrew Aid Society and no deduction for such contribution is permissible since petitioner had no net income in 1939. Section 23, I.R.C.

Decision will be entered under Rule 50.

Entered June 24, 1947.

[Seal]

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The Tax Court of the United States  
Docket No. 8058

MITCHELL CAMERA CORPORATION,  
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

### DECISION

Pursuant to the Memorandum Findings of Fact and Opinion of the Court entered in the above-entitled proceeding June 24, 1947, the respondent having filed his computation on August 26, 1947, and the petitioner having filed its acquiescence therein on September 4, 1947, it is

Ordered and Decided that for the year 1941 there is a deficiency in income tax of \$47,720.78, and no deficiency in declared value excess-profits tax.

Entered Sept. 9, 1947.

[Seal]

/s/ J. RUSSELL LEECH,  
Judge.

[Title of Tax Court and Cause.]

MOTION TO VACATE AND SET ASIDE THE  
MEMORANDUM FINDINGS OF FACT  
AND OPINION

Comes now the petitioner, Mitchell Camera Corporation, by Harry Friedman, its counsel, and moves the Tax Court of the United States to vacate and set aside its memorandum findings of fact and opinion entered June 24, 1947, and in support of said motion states as follows:

1. That the Tax Court of the United States is an agency of the Government of the United States within the meaning of Section 2 of the Administrative Procedure Act (Chapter 324—Public Law 404) and James Russell Leech, Judge of the Tax Court of the United States, is the presiding officer of that agency within the meaning of Sections 7 and 8 of the Administrative Procedure Act. See *The Lincoln Electric Co. vs. Commissioner*, Sixth Circuit Court of Appeals—decided June 5, 1947. (1947 CCH Tax Reporter, Paragraph 9282.)

2. That on October 22nd and 23rd, 1946, a hearing was held in Docket No. 8058 at Washington, D. C., which hearing was presided over by said James Russell Leech, Judge of the Tax Court of the United States. [54]

3. That on June 25, 1947, petitioner, through its counsel, received a copy of the memorandum findings of fact and opinion in Docket No. 8058

dated June 24, 1947, by United States mail from the said Court.

4. That said memorandum findings of fact and opinion dated June 24, 1947, was an initial decision of the said Court within the meaning of Section 8 (a) of the Administrative Procedure Act, but was served on petitioner without notice and without giving petitioner a reasonable time to submit its objections and exceptions to said initial decision together with its reasons in support of said objections and exceptions, pursuant to Section 8 (b) of the Administrative Procedure Act.

Wherefore petitioner prays:

(1) That the memorandum findings of fact, heretofore entered herein dated June 24, 1947, be withdrawn.

(2) That petitioner be granted a reasonable time to file its objections and exceptions to the proposed findings of fact and opinion, pursuant to the Administrative Procedure Act.

Dated: July 23, 1947.

/s/ HARRY FRIEDMAN,  
Counsel for Petitioner.

Filed July 24, 1947.

[Endorsed]: Denied July 25, 1947.

/s/ J. RUSSELL LEECH,  
Judge.

In the United States Circuit Court of Appeals  
for the Ninth Circuit

T. C. Docket No. 8058

MITCHELL CAMERA CORPORATION,  
Petitioner on Review,  
vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent on Review.

PETITION FOR REVIEW AND ASSIGN-  
MENTS OF ERROR

To the Honorable Judges of the United States  
Circuit Court of Appeals for the Ninth Circuit:

Now comes the Mitchell Camera Corporation by  
its attorneys, Harry Friedman and Birger Tinglof  
and respectfully shows:

I.

Jurisdiction

That the petitioner on review is a Delaware corporation organized on July 12, 1929, with principal office at 665 North Robertson Boulevard, Los Angeles, California, that it filed its federal tax returns for the year 1941 with the Collector of Internal Revenue for the Sixth District of California, Los Angeles, California; whose office is within the jurisdiction of this Honorable Court; that the respondent on review is the duly appointed, qualified, [56] and acting Commissioner of Internal Revenue, hereinafter referred to as the Commis-



sioner, appointed and holding his office by authority of the laws of the United States; that the Court in which the review of this cause is sought is the United States Circuit Court of Appeals for the Ninth Circuit.

Petitioner files this petition for review pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

## II.

### Nature of Controversy

On February 27, 1945, the Commissioner of Internal Revenue mailed to the petitioner a notice of deficiency in income and declared value excess profits taxes for the year 1941 in the amounts of \$71,301.66 and \$2,177.28, respectively. The determination of the correct net taxable income of petitioner for the year 1941 requires the ascertainment of its correct net taxable income for the calendar years 1939 and 1940 because of the carry-over net losses applicable to those years. The deficiencies asserted were based on partial disallowance of the depreciation claimed on patents, and disallowance of certain "special expenses" and New York office expenses for the years involved.

The Mitchell Camera Company of California (hereinafter referred to as Mitchell of California) for a number of years prior to 1929 was engaged in the business of manufacturing professional motion picture cameras and accessories for the large motion picture studios in California. All of



its business was in patented products manufactured under patents which it owned. In 1929 the introduction of "sound" motion pictures revolutionized the motion picture industry and Mitchell of California became the sole supplier of cameras for the major motion picture studios. This was due to the fact that under its patents it produced a relatively noiseless camera in comparison with that of its competitors. Because of the patented features of the Mitchell camera it was [57] practically impossible to use any other camera in the production of "sound" motion pictures.

On June 6, 1929, Harley L. Clarke, entered into a contract to purchase the assets of Mitchell of California for \$1,475,000.00, part of which was to be paid in cash and the balance in stock. The terms of this contract were changed, and Clarke instead paid to the stockholders of Mitchell of California, the sum of \$1,475,000.00 in cash. Clarke testified in the Tax Court, as a witness for the Commissioner, that he paid an additional sum of \$350,000.00 to \$400,000.00 in commissions on this purchase, making the total cost of the property to him at least \$1,825,000.00.

On July 16, 1929, petitioner's Board of Directors accepted a proposal submitted by Clarke to sell to petitioner, for \$3,100,000.00 in cash, all of the property which he had acquired from Mitchell of California. Thereafter, Clarke caused said property to be delivered to petitioner, and petitioner paid to Clarke, in consideration therefor, the sum of \$3,100,000.00.

On May 15, 1945, petitioner filed a petition with the Tax Court of the United States appealing from the deficiency asserted by the Commissioner. The Commissioner filed his answer on June 20, 1945, and the case came on for hearing before Judge Leech in Washington, D. C., on October 22nd and 23rd, 1946. Petitioner filed an amended petition on November 4, 1946, to which the Commissioner filed his answer on November 18, 1946.

On June 24, 1947, the Tax Court entered its opinion, in which it generally sustained the petitioner's contentions with respect to the special expense and New York office expense items, but ruled for the Commissioner on the depreciation issues. On July 24, 1947, the petitioner by motion requested the Tax Court to vacate and set aside its findings of fact and opinion on the ground that the Tax Court is an agency of the United States within the meaning of [58] Administrative Procedure Act (Chapter 324, 60 Stat. 237, Title 5, Ch. 19 USCA), and that petitioner was given no opportunity as required by that Act to submit objections or file exceptions to the said opinion, or "initial decision," prior to its issuance. The motion was denied on July 25, 1947.

On August 26, 1947, the Commissioner filed a computation in compliance with the opinion of the Tax Court, in which he reduced the asserted income tax deficiency of petitioner for the year 1941 to \$47,720.78, and eliminated the deficiency in declared value excess profits tax. Petitioner acquiesced in this computation, subject to right of appeal. The

Tax Court entered its final decision in the case on September 9, 1947, wherein it ordered and decided that there is a deficiency in income tax of \$47,720.78, and no deficiency in declared value excess profits tax.

The principal issue in this case concerns the basis for depreciation of the patents which petitioner purchased from Harley L. Clarke, and which he in turn had purchased from Mitchell of California. It is petitioner's position that the proper basis for depreciation of these patents is \$2,860,-178.95, representing the \$3,100,000.00 which it paid Clarke for the assets formerly owned by Mitchell of California, less \$239,821.05 which is the agreed value of the tangible assets. The Commissioner contends that the basis of the patents to petitioner is \$1,180,157.59, representing the \$1,475,000.00 which Clarke paid to Mitchell of California for its assets, less \$294,842.41 which is claimed to be the cost of the assets other than goodwill.

Other issues concern whether depreciation should not be spread over the entire statutory life of the patents, rather than computed on an average life basis as was done by the Commissioner; whether, if cost to Clarke is to be considered the basis to petitioner, there should not be added to such basis the commissions which Clarke paid in order to acquire the assets from Mitchell of [59] California; whether the basis of the patents should not be adjusted to reflect the amount of annual depreciation which, on Commissioner's theory would be correct, where petitioner because of mathematical

error took depreciation in excess of that amount for the years 1932-1938, but this resulted in its receiving no tax benefit except for the year 1936; whether the stipulated value of the net tangible assets is not the correct figure which should be deducted from the total cost of the assets in arriving at the cost basis of the patents.

### III.

#### Assignments of Error

The petitioner, being aggrieved by the findings of fact and conclusions of law contained in the decision of the Tax Court of the United States and by its final order determining a deficiency in income tax of \$47,720.78 for the year 1941 desires to obtain a review by the United States Circuit Court of Appeals for the Ninth Circuit.

The petitioner's assignments of error are as follows:

1. The Tax Court erred in not holding and deciding that the cost to petitioner of the assets and business of Mitchell of California was \$3,100,000.00.

2. The Tax Court erred in not holding and deciding that the correct basis for depreciation of the patents which petitioner acquired when it purchased the assets and business of Mitchell of California was \$3,100,000.00 less the agreed value of the tangible assets.

3. The Tax Court erred in holding and deciding that petitioner did not prove that its actual cost of the assets and business of Mitchell of California was in excess of \$1,475,000.00.

4. The Tax Court erred in holding and deciding that the basis for depreciation of patents which petitioner purchased from Harley L. Clarke is to be determined by reference to the price which Clarke paid to Mitchell of California for its business and assets. [60]

5. The Tax Court erred in holding and deciding that the assets of Mitchell of California acquired by petitioner included substantial value in goodwill and intangibles other than patents.

6. The Tax Court erred in holding and deciding that the Commissioner might properly compute depreciation on the group of patents acquired by petitioner on the basis of the average life of the patents, rather than by spreading depreciation over the entire life of all the patents.

7. The Tax Court erred in not holding and deciding that depreciation on a group of patents with varying lives should be computed by allowing in each year as depreciation that portion of the total cost of the group of patents which bears the same relation to the total cost as the life of the patents expiring in each year bears to the total unexpired life of the group on the date of acquisition.

8. The Tax Court erred in not holding and deciding that the \$350,000 to \$400,000 which the Government witness, Harley L. Clarke, testified without contradiction that he paid as commissions to acquire the assets of Mitchell of California must be added to Clarke's cost of the assets if such cost is to be treated as the cost of the assets to petitioner.



9. The Tax Court erred in not holding and deciding that, where petitioner through error took depreciation for the years 1932 through 1938 in excess of the amount which on Commissioner's theory would be correct, but except for the year 1936 received no tax benefit as a result, the basis for computing depreciation for the years in controversy should be adjusted to reflect the correct amount of depreciation for earlier years.

10. The Tax Court erred in holding and deciding that a figure other than the stipulated value of the net tangible assets might be deducted from the total cost of the assets formerly owned by Mitchell of California in arriving at the cost basis to petitioner of the patents included in such assets. [61]

11. The Tax Court erred in entering its final order and decision that there is a deficiency in petitioner's income tax for the year 1941 of \$47,720.78.

12. The Tax Court erred in that its decision is not supported by the evidence.

13. The Tax Court erred in that its decision is contrary to the law and regulations.

14. The Tax Court erred in denying petitioner's motion to set aside its memorandum findings of fact and opinion for the reason that the Tax Court is an agency of the United States within the meaning of the Administrative Procedure Act (Chapter 324, 60 Stat. 237, Title 5, Ch. 19 USCA), and petitioner was given no opportunity as required by that Act to submit objections or to file exceptions to said opinion or "initial decision" prior to its issuance.



Wherefore petitioner prays that the decision of the Tax Court of the United States be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit, that a transcript of record be prepared in accordance with the rules of said Court and transmitted to the Clerk of said Court for filing, and that proper action be taken to the end that the errors complained of may be reviewed by said Court.

/s/ HARRY FRIEDMAN,  
/s/ BIRGER TINGLOF,  
Attorneys for Petitioner.

District of Columbia—ss.

Harry Friedman, being duly sworn, deposes and says:

I am one of the attorneys for the petitioner in this proceeding; I have read the foregoing petition and am familiar with the contents thereof. The statements contained therein are true to the best of my knowledge, information and belief. This petition is not filed for the purpose of delay and I believe the petitioner is justly entitled to the relief sought.

/s/ HARRY FRIEDMAN.

Subscribed and sworn to before me this 29th day of October, 1947.

[Seal]      /s/ FRANK E. ELDER,  
Notary Public.

Filed T.C.U.S. Nov. 3, 1947. [63]

[Title of Circuit Court of Appeals and Cause.]

NOTICE OF FILING PETITION  
FOR REVIEW

To: Commissioner of Internal Revenue, Internal  
Revenue Building, Washington, D. C.

Charles Oliphant, Esq., Chief Counsel, Bureau of  
Internal Revenue, Washington, D. C.

You are hereby notified that the Mitchell Camera Corporation did on the 3rd day of November, 1947, file with the Clerk of the Tax Court of the United States, at Washington, D. C., a Petition for Review by the United States Circuit Court of Appeals for the Ninth Circuit, of the decision of the Tax Court heretofore rendered in the above-entitled cause. A copy of the Petition for Review and the Assignments of Error as filed is hereto attached and served upon you.

Dated: November 3, 1947.

/s/ HARRY FRIEDMAN,

Attorney for the Petitioner.

Personal service of the above and foregoing notice, together with a copy of the Petition for Review and assignments of error mentioned therein, is hereby acknowledged this 3rd day of November, 1947.

/s/ CHARLES OLIPHANT, OWS

Chief Counsel, Bureau of  
Internal Revenue.

Filed T.C.U.S. Nov. 3, 1947. [64]

[Title of Circuit Court of Appeals and Cause.]

### STATEMENT OF POINTS

Now comes the Mitchell Camera Corporation, the Petitioner on Review herein, by its attorneys, Harry Friedman and Birger Tinglof, and hereby asserts the following errors on which it intends to rely in this review:

1. The Tax Court erred in not holding and deciding that the cost to petitioner of the assets and business of Mitchell of California was \$3,100,000.00.

2. The Tax Court erred in not holding and deciding that the correct basis for depreciation of the patents which petitioner acquired when it purchased the assets and business of Mitchell of California was \$3,100,000.00 less the agreed value of the tangible assets.

3. The Tax Court erred in holding and deciding that petitioner did not prove that its actual cost of the assets and business of Mitchell of California was in excess of \$1,475,000.00.

4. The Tax Court erred in holding and deciding that the basis for depreciation of patents which petitioner purchased from Harley L. Clarke is to be determined by reference to the price which Clarke paid to Mitchell of California for its business and assets.

5. The Tax Court erred in holding and deciding that the assets of Mitchell of California acquired by petitioner included substantial value in [65] goodwill and intangibles other than patents.

6. The Tax Court erred in holding and deciding

that the Commissioner might properly compute depreciation on the group of patents acquired by petitioner on the basis of the average life of the patents, rather than by spreading depreciation over the entire life of all the patents.

7. The Tax Court erred in not holding and deciding that depreciation on a group of patents with varying lives should be computed by allowing in each year as depreciation that portion of the total cost of the group of patents which bears the same relation to the total cost as the life of the patents expiring in each year bears to the total unexpired life of the group on the date of acquisition.

8. The Tax Court erred in not holding and deciding that the \$350,000 to \$400,000 which the Government witness, Harley L. Clarke, testified without contradiction that he paid as commissions to acquire the assets of Mitchell of California must be added to Clarke's cost of the assets if such cost is to be treated as the cost of the assets to petitioner.

9. The Tax Court erred in not holding and deciding that, where petitioner through error took depreciation for the years 1932 through 1938 in excess of the amount which on Commissioner's theory would be correct, but except for the year 1936 received no tax benefit as a result, the basis for computing depreciation for the years in controversy should be adjusted to reflect the correct amount of depreciation for earlier years.

10. The Tax Court erred in holding and deciding that a figure other than the stipulated value of the

net tangible assets might be deducted from the total cost of the assets formerly owned by Mitchell of California in arriving at the cost basis to petitioner of the patents included in such assets.

11. The Tax Court erred in entering its final order and decision that there is a deficiency in petitioner's income tax for the year 1941 of \$47,720.78.

12. The Tax Court erred in that its decision is not supported by the evidence.

13. The Tax Court erred in that its decision is contrary to the law and regulations.

14. The Tax Court erred in denying petitioner's motion to set aside its memorandum findings of fact and opinion for the reason that the Tax Court is an agency of the United States within the meaning of the Administrative Procedure Act (Chapter 324, 60 Stat. 237, Title 5, Ch. 19 USCA), and petitioner was given no opportunity as required by that Act to submit objections or to file exceptions to said opinion or "initial decision" prior to its issuance, or to obtain review by the Tax Court of the report of the Judge who heard the case.

/s/ HARRY FRIEDMAN,

/s/ BIRGER TINGLOF,

Attorneys for Petitioner.

Service of a copy of the within statement of points is hereby admitted this 2nd day of January, 194...

/s/ CHARLES OLIPHANT, CAR

Chief Counsel, Bureau of  
Internal Revenue.

Filed T.C.U.S., Jan. 2, 1948. [67]



[Title of Circuit Court of Appeals and Cause.]

## STATEMENT OF EVIDENCE

The above-entitled proceedings came on for hearing on October 22nd and 23rd, 1946, before the Honorable J. Russell Leech, Judge of The Tax Court of the United States. The Petitioner appeared by its attorney, Harry Friedman, Esquire, and the Respondent appeared by his attorney, E. M. Woolf, Esquire.

The proceedings were heard on a stipulation of facts, oral testimony and documentary evidence. All of the oral testimony introduced which is material and necessary for the determination of the assignments of error set out by the Petitioner on Review in his petition for review by this Court of the decision of the Tax Court, is set out herein in narrative form.

Statement of Case on Behalf of Petitioner  
By Mr. Friedman:

If your Honor please, this is the petition of the Mitchell Camera Corporation, a Delaware corporation, organized in July, 1929. The taxable year involved is the year 1941, but issues are raised as to the years 1939 and 1940, [68] as well as 1941, because of the net operating loss carried over for those two years, which affects the tax year 1941. The deficiency involved is \$71,301.66 in income taxes and \$2,177.28 in declared value excess profit taxes for the year 1941.

The case involves two sets of issues, the first one being what we might call the patent issue. The



controversy with respect to the patents arises out of the purchase by Mr. H. L. Clarke under an agreement of July 6, 1929, of all the property of a California corporation of the same name, Mitchell Camera Corporation. And I think it might be better for the sake of clarity to refer to that as the California corporation, and the Petitioner as the Delaware corporation.

The evidence will show that Mr. Clarke purchased the property of the California corporation for \$1,475,000.00 in cash, and that he sold that property to the Petitioner shortly thereafter for \$3,100,000.00 in cash. There is no controversy over those facts at that point.

The California corporation for a number of years prior to 1929 was engaged in the business of manufacturing motion picture cameras for the large motion picture producers in southern California. Its product was protected by a number of patents, about thirty patents, which we have here. The superiority of the Mitchell camera depended entirely upon these patented features.

The evidence will show that without these patents there would have been no Mitchell camera, nor a Mitchell Camera Corporation, because anyone owning the patents would control the business of making the Mitchell camera.

The property purchased by Clarke and later resold to the Petitioner was offered to the Petitioner in a proposal which provided that he would sell to the Petitioner all of the business, property and assets of the California corporation. [69]

The tangible assets consisted of inventories, a small accounts receivable, land and building and a small piece of other land, which we are in agreement on had a fair market value at that time of \$239,821.05. There is no controversy over the value of the tangible assets. There is a little difference. In the deficiency letter the Commissioner used as the value of the tangible assets a figure of \$294,841.41, instead of the figure we have now stipulated, \$239,821.05.

The issue with respect to the patents arises out of the balance of the purchase price, the difference between the \$3,100,000.00 and the \$239,000. The question there is whether that difference is to be allocated to patents, the backbone of the California corporation and the only other asset the California corporation had, or to something else, good will or other intangibles, whatever the Commissioner might claim.

The Commissioner in this case has done this: He has based our patent cost on the cost paid by Mr. Clarke to the owners of the California corporation, rather than the cost which we paid to Mr. Clarke. He has taken the \$1,475,000 which Mr. Clarke paid, applied against that the value of the tangible assets, and attributed the balance to patents. We say in that he has erred, that our cost was the \$3,100,000.00, irrespective of what Mr. Clarke may have paid for the property prior to the time he sold it to the Petitioner.

The transaction was one transaction in a series of transactions involving the formation of the General Theatres Equipment Company, and I think the

Government will attempt to bring that transaction into the case. We will attempt to show that that has nothing to do with our particular problem.

We have stipulated that after your decision on those issues, the question of the amount of net carry-over from 1939 and 1940 to 1941 may be settled under Rule 50 of this Court. [70]

### Statement of Case on Behalf of Respondent

By Mr. Woolf:

May it please your Honor, the principal issue involved here, the cost or basis of the patents acquired by the Petitioner corporation, is not as simple as counsel for the Petitioner seems to think, insofar as the Respondent has developed the facts. I would like to make a short statement of the facts that the Respondent will admit and I feel which we will present at the hearing.

In the early part of 1929, Mr. Clarke was engaged, among other things, in the theatre supply business. He owned or controlled the International Projector Corporation, and I think at that time there was contemplated organizing a corporation, which was later organized, and which was known as General Theatres Equipment, Incorporated. Mr. Clarke, on behalf of himself or on behalf of this new corporation, was anxious to acquire four so-called lamp companies. They will be brought out,—the names of them will be brought out in the testimony. He was also anxious to acquire, for himself or on behalf of G.T.E., the Mitchell Camera Corpo-

ration of California, which owned the patents, or the stockholders owned the patents or patent rights at that time.

Mr. Clarke, I believe, had several conversations with Mr. William Fox, who at that time either owned or controlled Fox Film Corporation and Fox Theatre Corporation among other corporations that were owned or controlled by Fox or the Fox family.

There was some discussion as to whether they would acquire these corporations or companies jointly, and whether both parties would have an interest therein, or just how the transaction should be handled.

There were several letters exchanged about May 24, 1929,—May 25, 1929, and I believe Mr. Fox about that time put up \$50,000.00. The Mitchell Camera Corporation of Delaware was to be organized,—the Petitioner here,—and that corporation was to hold the patents and all of the properties of the [71] old Mitchell Camera Company of California.

A corporation by the name of Grandeur, Incorporated, was to be organized. Grandeur, Incorporated, was to own all of the stock of the Petitioner. General Theatres Equipment was to own one-half of the stock of Grandeur, and it later developed that Mr. William Fox owned the other half of Grandeur.

There is some question just how the transaction was handled, as the checks for acquiring the properties all went the same day, August 1st or 2nd, 1929. In the meantime, Mr. Clarke acquired the

four lamp companies, and also acquired the properties, assets, patents and patent applications of the Mitchell Camera Company of California.

The General Theatres Equipment on August 1, 1929, sold stock and bonds, or securities, for which it received \$11,400,000.00. Of that fund, our information discloses that five million dollars was allocated for Mr. Clarke to acquire the four lamp companies and one-half of the Grandeur stock.

There was some agreement between Mr. Clarke and Mr. Fox whereby he was to receive this one-half interest in Grandeur, Incorporated. So Mr. Clarke acquired Mitchell Camera Company's assets, patents and patent applications for \$1,475,000.00. I do not believe he ever acquired possession of the assets, but the assets were transferred to the Mitchell Camera Corporation of Delaware, the Petitioner contends for \$3,100,000.00. That transaction took place within six weeks or so at the time that Mr. Clarke acquired those assets.

On August 1, 1929, Mr. Clarke gave Mr. Fox a check—two checks—one for \$1,625,000.00 and one for \$375,000.00, making a total of \$2,000,000.00. Mr. Fox gave a check to Grandeur, Incorporated, for \$1,950,000.00, and I believe the difference there was the credit of \$50,000 which he had already put up with Mr. Clarke, for which he was to receive one-half of the outstanding stock of the Grandeur corporation. [72]

Now Mr. Clarke, on behalf of General Theatres Equipment, which corporation was to acquire the other half of Grandeur, Incorporated, paid into



Grandeur, or gave credit to Grandeur, of \$2,000,000.00. So Grandeur had four million dollars August 1st or August 2nd, 1929.

I am not quite sure whether the \$3,100,000.00 was paid by Grandeur directly back to Mr. Clarke, or whether it went into the Mitchell Camera Corporation of Delaware, the Petitioner here, and then on the same day to Mr. Clarke, but the way it ended, Grandeur had a working capital, had cash, which we will show by the balance sheet attached to the return, of \$900,000.00. Grandeur in addition owned all the capital stock of the Mitchell Camera Corporation, the Petitioner.

Mitchell Camera Corporation didn't keep any of the three million, one hundred thousand. If they received it, they received it with the agreement that they would immediately transfer it over to Mr. Clarke. So the Respondent's position as to the cost basis is simply this: ,

The assets and the properties, the patents and the patent applications, were acquired by Mr. Clarke, as shown in the Deficiency Letter for \$1,475,000.00. Then a short period before he ever took possession of those properties they were transferred to the new corporation at a stepped-up basis of \$3,100,000.00.

General Theatres Equipment only had \$5,000,000.00 to acquire the four lamp companies and Grandeur. The money, that part of the five million dollars which was allotted to acquire Mitchell, went around in a circle and came back to Clarke, who was acting on behalf, I think, of G.T.E. Mr. Fox



was given a one-half interest in the Grandeur corporation—what the consideration was will be developed at the hearing—and the cost of the patents to Petitioner was the difference between the \$1,475,000.00 and the tangible assets, or as [73] shown in the Deficiency Letter, \$1,180,157.59.

Grandeur, Inc., filed consolidated returns with Mitchell Camera Corporation for a few years. In 1934 the question arose as to the years of 1930 and 1931 as to the basis of the patents. Now, conferences were held, protests were filed. The Petitioner submitted their facts. At that time it was agreed that the cost basis of the patents was \$1,180,157.59.

The Court: Cost basis to whom?

Mr. Woolf: To the Petitioner.

The Court: Who made the agreement?

Mr. Woolf: The Petitioner and the Bureau of Internal Revenue. In settling the deficiency for the years 1930 and 1931, they accepted that basis and it went on to the year 1941. The first time the question came up was in 1941, as to the new basis now claimed by the Petitioner.

The Respondent respectfully submits that the facts clearly show what the cost basis to the Petitioner was. At the time the case for 1930 and 1931 was settled, there was also a question as to the rate that the patents were to be depreciated or amortized. The petitioner contended that it was 12.366 years. In the petition, there is an allegation that the Commissioner erred in that allocation. I do not believe Mr. Friedman mentioned that this morning.

Mr. Friedman: I just overlooked it.

Mr. Woolf: In the event there is an attempt to change the method of allocation, which now he wants to put on a so-called monthly basis, that there were so many patents in existence during the taxable year, and so many months, Respondent takes the position that it will be necessary for him to allocate the cost basis that he claims for all of the patents against each patent, in order that we may determine the proper depreciation for the years 1939, 1940 and 1941. The only year involved is 1941, but there are carry-overs from the other two years.

The Court: Just a minute. What rate did Respondent apply in determining depreciation?

Mr. Woolf: The respondent accepted the Petitioner's contention that the cost of the patents was \$1,180,000 plus, and that they should be depreciated over 12.366 years.

The Court: As an aggregate?

Mr. Woolf: As an aggregate.

The Court: Now, as we understand, on this depreciation issue the Petitioner contends that its basis for the purpose of computing depreciation is the cost of these patents to the Petitioner, which they say is three million and odd dollars. As we understand, that figure is conceded by the Respondent, is that so, that the Petitioner actually paid—

Mr. Woolf: No, your Honor.

The Court: The statement was made, as we recall it, in the opening statement by counsel for the Petitioner, that that was conceded. You see, what we want to get at here, is the basis for depreciation, except for certain exceptions. Is that so?

Mr. Woolf: Cost of patents.

The Court: That is right.

Mr. Woolf: That is right.

The Court: Now, cost would be the basis here, unless one of the exceptions should apply, and I am trying to determine here as to which one or more of those exceptions the Respondent says these facts put the Petitioner in. Do you follow my question?

Mr. Woolf: Yes, your Honor. It is the position of the Respondent, first, that the petitioner did not pay three million, one hundred thousand dollars for the patents. It didn't have three million, one hundred thousand dollars to pay for all of the assets, including the tangible assets, and, which has not been mentioned here, good will, patents and tangible assets. [75]

It is the Respondent's position it is merely a stepped-up basis from one million four hundred and seventy-five thousand to three million, one hundred thousand; that the difference merely went back to Mr. Clarke, who really originally acquired the properties, and the Petitioner corporation never had that amount to acquire the patents.

The Petitioner set the properties up on its books and attributed \$2,805,000.00 to good will on the books. So the Respondent takes the position, first, that it didn't have three million one hundred thousand to pay for patents; that Mr. Clarke on behalf of G.T.E. received back the three million one hundred thousand, of which two million had just passed through Mr. Fox for the purpose of giving him a

half interest in the Grandeur corporation.

The Court: Well, then, it is your position that as a matter of fact the Petitioner did not pay this three million odd dollars for the patents; secondly, if it did pay it, that part of it was properly allocable to something other than patents?

Mr. Woolf: Good will, or something else—what Mr. Fox acquired.

The Court: Have I stated that rightly?

Mr. Woolf: That is correct.

Supplemental Statement on Behalf  
of Petitioner

Mr. Friedman: I should like to supplement the opening statement on this question of the basis of apportioning depreciation. The Commissioner has used the average life method, 12.366 years. Our position is that that exhausts the patent base or cost, whatever it might be, prior to the expiration of the life of the patents, and therefore is not a proper basis; that the correct basis of allocation is that set by this Court in the Simmons case, 8 B.T.A. 621, where the patents were depreciated over their full life. You took the total number of months of the life of the patents and made a fraction. On top you used the number of months which expired within the taxable year. Here the total life of the patents is 4452 months. 212 months expire within one taxable year, so [76] the proper depreciation for that year would be 212 over 4452.

Now on the question of this prior agreement, which your Honor has just heard, it is not the tax-

payer who is really repudiating that agreement, if there was such an agreement, because in this case under the 1934 settlement the life of the patents would expire some time in the year 1941, and we would be entitled to depreciation on those patents on whatever basis we had through the year 1941.

Now in the Deficiency Letter, as your Honor will notice, we are allowed the depreciation for 1939, we are allowed approximately half of it for 1940, and we are allowed none of it for 1941.

The Commissioner reaches that result by taking as the depreciation allowed for prior years the amounts we erroneously took on some of our returns in those years, but we have not gotten credit for tax purposes for our real base even on the Commissioner's idea.

Further with respect to the settlement, it was not a closing settlement of any kind. Of course, if it is wrong it can be corrected by either the Respondent or the Petitioner. It is not *res adjudicata* in this case.

The Court: Well, we do not understand it is being contended it is *res adjudicata*. Is that your contention?

Mr. Woolf: No, your Honor, we have not pleaded *res adjudicata*.

The Court: We notice no plea of *res adjudicata*, and obviously there was no basis for such a plea. You have a stipulation.

(Thereupon the Court received and filed the stipulation of the parties, with Petitioner's Exhibits 1-10, inclusive, attached.)



Mr. Friedman: If your Honor please, as you will see from the stipulation, Mr. Clarke made an offer to the Mitchell Camera of Delaware on July 12, [77] 1929——

The Court: Where are you reading from?

Mr. Friedman: Exhibit 1, your Honor. Made an offer to the Mitchell Camera Corporation of Delaware on July 12, 1931——

The Court: 1929.

Mr. Friedman: 1929, offering to sell to that corporation all of the properties, business and assets of the Mitchell Camera Company, the California corporation. And your Honor will see in the next to the last paragraph that: "In consideration of the foregoing you shall pay to or upon the order of the undersigned the sum of \$3,100,000 in cash."

That offer was presented to the Board of Directors. You will see that on Exhibit No. 2. That offer was presented to the Board of Directors of the Mitchell Camera Corporation of Delaware at a meeting held on July 16, 1929. That is beginning the last paragraph on the second page of Exhibit 2. "The Chairman then stated that there had been received the following proposal from Mr. H. L. Clarke," and the proposal of July 12th follows.

Then at the top of the next page, that proposal was accepted by resolution, which reads: "Resolved that the foregoing proposal be, and the same is, hereby accepted, and the proper officers of this Corporation be and they are hereby authorized and directed to execute any and all checks, documents or papers necessary or proper to carry this resolution into effect."



Then there follows a resolution under which the Grandeur Company purchased the stock of the Mitchell Camera Company for \$3,100,000 in cash. I believe the Government has the check which was paid for that stock. There is no question about the \$3,100,000 having been paid in to the Mitchell Camera Corporation and having been paid out of the Mitchell Camera Corporation—no question. [78]

Mr. Woolf: On the part of the petitioner, your Honor.

Mr. Friedman: Well, the proof shows it. Then the stipulation shows the documents under which the property was transferred to Mitchell Camera Corporation, the assignments of patents. Then we have stipulated a list of patents, together with the expiration dates, and the total number of unexpired months of life. That is Exhibit 8, your Honor. Those are the assignments you have there, 5, 6, 7 and 8. Exhibit 8 is a list of patents with the patent numbers, the dates of expiration, the term in years, the number of months which expired prior to December 31, 1938, and the number of months which expired in each one of the taxable years, 1939, 1940 and 1941. You will see that some of those patents do not expire until 1948, 1949, 1943, 1950 and so on, beyond the year 1941.

And then we also have stipulated here the copy of agreement under which Mr. Clarke purchased the property from Mr. George A. Mitchell and Mr. H. F. Boeger, the owners of the California corporation.

If your Honor please, I should like to offer in

evidence the Patent Certificates referred to in the stipulation.

The Court: Is there objection?

Mr. Woolf: May I see them? (Same were shown to counsel.) No objection, your Honor.

The Court: As we notice from the stipulation, the last identified exhibit attached to the stipulation is Exhibit 10. Is that right?

Mr. Friedman: Yes, your Honor, No. 10.

The Court: This exhibit will be identified as Petitioner's Exhibit No. 11, and received as such.

(The documents above referred to were received in evidence and marked Petitioner's Exhibit No. 11.) [79]

Mr. Friedman: I should like to call Mr. George A. Mitchell.

### GEORGE A. MITCHELL

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

#### Direct Examination

By Mr. Friedman:

I reside in Pasadena, California. I have been connected with the motion picture camera business since 1912. I am employed by the Petitioner as Engineer in Charge of Production and Development. In 1929 and prior thereto I was a stockholder and officer of the Mitchell Camera Corporation of California. In June 1929 I owned a  $\frac{1}{3}$  interest in

(Testimony of George A. Mitchell.)

the Mitchell Camera Corporation of California and Henry F. Boeger owned the other  $\frac{2}{3}$ rds. I was engineer in charge of production and development of the California corporation. I am the inventor named in the various patents shown in Petitioner's Exhibit No. 11. In 1929, Mr. Boeger and I sold our interest in the Mitchell Camera Corporation to H. L. Clarke. We both continued with the new company after we sold out. I was engaged as engineer in charge of production and development, the same position I had before. In 1929 the Mitchell Camera Corporation of California manufactured professional motion picture cameras used by studios. The new company continued in the same business. Its products were protected by patents on inventions owned by me or the corporation. All of the company's business was in patented products. In 1929 the company's principal customers were the major studios producing pictures. The studios started to become important customers of Mitchell Camera Corporation about the year 1927 when sound came into the picture business. We were fortunate enough to have a camera that was very quiet, compared to others. So far as I know the studios in 1929 did not purchase any cameras other than ours. We had the only camera which could be [80] used with sound so we became flooded with orders. In 1929 we were far behind in meeting our orders.

We attribute the position of the Mitchell Camera Corporation in 1929 to patents. We had patent protection on our products. The business of Mitchell

(Testimony of George A. Mitchell.)

Camera Corporation was based upon its patents. Good will was not a factor in the business in 1929.

Mr. Clarke did not have any interest in the Mitchell Camera Corporation of California prior to the time he entered into the contract to buy it. Mr. William Fox did not own any stock in the Mitchell Camera Corporation of California.

### Cross-Examination

By Mr. Woolf:

Q. Mr. Mitchell, when were you first approached in regard to the sale of Mitchell Camera of California?

A. Well, sir, I don't think I can answer that question. I was in an engineering capacity, and my partner, Mr. Boeger, was the business man, and he handled all of that.

We discussed what we were going to do, and I knew some of his plans. It was probably in the fall or winter of 1928-1929, some time in there. My partner, H. F. Boeger, wanted to get out of business. He thought we could sell to DuPont. At that time I told him that the people who might be interested in buying the business was the Grandeur Corporation, a company that we had been doing business with. A man by the name of E. I. Sponable had been the man that we had had contact with regarding the Grandeur Camera, and I told my partner he might see Sponable who might be interested in the corporation.

My partner went to New York and contacted Mr.

(Testimony of George A. Mitchell.)

Sponable, and through rumors we got back in various ways we heard that he had been introduced to a man by the name of Harley Clarke. I first learned early in 1929 or late in 1928 that Mr. Harley Clarke was interested in acquiring the corporation. The Grandeur [81] Corporation that I mentioned is the same Grandeur Corporation that acquired the stock of the Mitchell Camera Corporation of Delaware. I didn't know whether Mr. Clarke was acquiring the Mitchell Camera Corporation for himself, or as agent for somebody else. I haven't any idea how much was paid for the assets. I know how much we received, which was \$1,475,000.00.

Q. And that was under the contract which we have stipulated here, June 6, 1929, I believe?

A. I presume so.

Q. I show you what purports to be a contract of June 6, 1929, and ask you if that is the contract under which Mr. Clarke acquired the assets of the Mitchell Camera Corporation of California?

A. Well, as far as I know, yes.

(Thereupon there was offered and received in evidence as Respondent's Exhibit A a photostatic copy of document which the witness identified as agreement placing in escrow the assets of the Mitchell Camera Corporation of California which the witness and his partner, H. F. Boeger, agreed to sell to Harley L. Clarke.)

I testified that the properties and assets of the Mitchell Camera Corporation were sold for \$1,475,000.00. I had nothing to do with arriving at that



(Testimony of George A. Mitchell.)

figure. I gave Mr. Boeger power of attorney, and I didn't instruct him in any way. I was agreeable to anything Mr. Boeger did. I knew he would look after my interest. I owned a one-third interest in the corporation and I accepted that figure.

In connection with the sale of the assets of Mitchell Camera Corporation of California, Mr. Boeger and I agreed that we would not engage in or become interested in any motion picture camera business other than with the buyer or with the Mitchell Camera Corporation of Delaware for a period of five years. That was a customary agreement. In 1929 I became an employee of the Mitchell Camera Corporation of Delaware. I was not an officer in that corporation, nor so far as I know, a director. I don't know who the officers, directors or stockholders were. Mr. Boeger was the business manager.

Q. You do know Mr. Clarke paid \$1,475,000.00 for all of the assets of the Mitchell Camera?

A. I know we received that amount of money.

Q. Answer this yes or no: Do you know as a fact what Mitchell Camera Corporation of Delaware paid to Mr. Clarke?      A. No, sir.

### Redirect Examination

By Mr. Friedman:

I was employed by the new corporation for a period of about five years at \$25,000 a year. On, I think, the 28th of June, 1929, Mr. Clarke called and said that they had decided to pay all cash for



(Testimony of George A. Mitchell.)

the assets of Mitchell of California, so that the agreement was consummated in cash rather than in stock. We got the money in the Fall of 1929; I think it was about September.

(Witness excused.)

(Thereupon there was offered and received in evidence as Respondent's Exhibit B the minutes of March 16, 1932, Special Meeting of Board of Directors of Mitchell Camera Corporation and the minutes of a Special Meeting of Board of Directors held in New York on August 2, 1929. There was also offered and received in evidence, as Petitioner's Exhibit No. 12, the charter of Mitchell Camera Corporation of Delaware.)

### SIDNEY R. REED

called as witness for and on behalf of Petitioner, having been first duly sworn, was examined and testified as follows:

#### Direct Examination

By Mr. Friedman:

(Thereupon there was offered and received in evidence as Petitioner's Exhibit 13 the income tax return for the year 1931 filed by Grandeur, Inc., which was a consolidated return of Grandeur, Inc., and Petitioner.

(Testimony of Sidney R. Reed.)

(There was also offered and received in evidence [83] as Petitioner's Exhibit 14 a letter dated January 5, 1934, from the Internal Revenue Agent in Charge in New York in reference to his examination of Petitioner's return for the year 1931.)

My home is in Burbank, California. I am auditor, accountant and tax consultant and a member of the accounting firm of Sidney R. Reed & Co. I have been an accountant for the Petitioner since 1941, and first prepared its tax return for that year. In connection with the preparation of that return I examined into the history of the company from its inception. I examined the tax returns for prior years and the Revenue Agent's reports relating thereto. I have seen the minutes of the Special Meeting of the Board of Directors held on July 16, 1929, which Minutes are attached to the stipulation and marked Exhibit 2. I audited the transaction referred to in those minutes because the Examining Agent in reviewing the 1941 return questioned the amortization which the company claimed. In examining into the validity of this proposed assessment, I went back to the inception of the company to establish the proper basis for amortization of patents. I found that the transactions referred to in the minutes were consummated.

(Witness temporarily excused.)

## HARLEY L. CLARKE

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

## Direct Examination

By Mr. Friedman:

I reside at 2603 Sheridan Road, Evanston, Illinois. I was subpoenaed here as witness for the government in this proceeding. My signature appears on the proposal which is Petitioner's Exhibit 1, attached to the stipulation. The next to the last paragraph of this proposal signed by me and dated July 12, 1929, says "In consideration of the foregoing you shall pay to or upon the order of the undersigned the sum of \$3,100,000.00 in cash." That proposal was accepted by the Petitioner, the Mitchell Camera Corporation of Delaware. A proposal on the [84] part of Grandeur, Inc., to purchase 30,000 shares of Petitioner, Mitchell Camera Corporation of Delaware, for the sum of \$3,100,000 was also accepted and that transaction was carried out.

(Thereupon the witness identified his signature on a photostatic copy of check payable to the Mitchell Camera Corporation under date of August 1, 1929, in the sum of \$3,000,000.00, signed by Grandeur, Inc., Harley L. Clarke, President, and endorsed "for deposit and credit to the account of Mitchell Camera Corporation

(Testimony of Harley L. Clarke.)

in the C.N.B.” This document was offered and received in evidence as Petitioner’s Exhibit 15.)

I received the consideration of \$3,100,000.00 referred to in this proposal.

Mr. Friedman: That is all.

### Cross-Examination

By Mr. Woolf:

Q. Mr. Clarke, you said you received \$3,100,000.00. Now let us think back to this transaction. Did you receive this \$3,100,000.00, from Grandeur, Incorporated, or did you receive this \$3,100,000.00 from Mitchell Camera Corporation of Delaware?—the Petitioner here?

A. The \$3,100,000.00 was received by one of the companies. I think if you have the other record, it will show you where it went.

Q. I merely ask you if you remember.

A. No, I do not.

Q. You don’t remember whether you received it from Grandeur? A. No.

Q. Or whether you received it from the Petitioner? A. I do not.

Mr. Woolf: That is all, your Honor.

The Court: You are excused.

(Witness excused.)

The Court: The witness who left the stand temporarily a few minutes ago, will resume the stand.

## SIDNEY R. REED

called as witness for and on behalf of petitioner, having been previously duly sworn, resumed the stand and was examined and testified further as follows:

## Direct Examination

(Continued)

By Mr. Friedman:

After the agent examined the 1941 return I directed that entries be made on the books of the Petitioner corporation to adjust the patent account, the good will account, and the reserve for amortization.

Q. What entries were made by you, Mr. Reed?

A. The patent account was charged with \$1,625,000.00; the good will, franchise rights and going concern were credited with \$1,625,000.00. The explanation is: "To increase patents cost to actual amount paid for same at inception of company. This amount was erroneously charged to good will, franchise rights and going concern. See Revenue Agent's report dated January 5, 1934, and protest on brief filed with Internal Revenue Bureau dated February 10, 1944." I found that it was necessary to make these entries because, upon investigation to determine whether the agent was right, I determined that the company had acquired no good will at its inception and that the accountants at that time should have charged the patent account for their value, which was the difference between the value of tangible assets and the consideration paid for the entire assets. When I made those entries I



(Testimony of Sidney R. Reed.)

considered the net tangible assets at a figure of \$294,842.41. Now that it has been stipulated that the net tangible assets were in fact \$239,821.05, this change in the figure would make a difference in the entries which I made. It would further increase the patent value by a difference of \$55,021.36. I have prepared a computation showing the depreciation to which the Petitioner should be entitled in the years 1939, 1940, 1941 on the Commissioner's figure of \$1,180,000.00 (odd) and also on the Petitioner's figure of \$2,185,179.59.

Mr. Woolf: I object, your Honor. This merely is the witness' opinion of what should be the value. That is the question we are presenting to the Court. That is for the Court to determine and decide. I object on that ground, your Honor.

The Court: We overrule the objection, note an exception to the Respondent, and receive the exhibit, as merely being an expression of opinion of this witness and which opinion is based upon facts, evidence of which is already in this record. The objection is overruled and exception noted for the Respondent.

(Thereupon the document above referred to was offered and received in evidence and marked Petitioner's Exhibit 16.)

#### Cross-Examination

By Mr. Woolf:

The method which I used in preparing Exhibit 16 does not reflect the depreciation previously claimed on the returns filed by the Petitioner and allowed by the Commissioner.

(Testimony of Sidney R. Reed.)

Redirect Examination

By Mr. Friedman:

Q. Mr. Reed, will you please explain your last answer?

A. Yes. The books of the company, under the direction of Haskins and Sells, who audited the books, were adjusted to conform to the Commissioner's agreement in 1934 in conjunction with the audit of the 1931 return.

In preparing the return, I claimed amortization in accordance with that theory. The Examining Agent disregarded that theory theretofore followed by the Commissioner.

Q. In what respect?

A. In the respect of the unused amortization, the Commissioner [87] accumulates a greater reserve than should be taken under the theory followed by the Commissioner in 1934.

Q. So that by accumulating more than would be allowable under the 1934 adjustment——

A. Yes.

Q. ——the Commissioner denies depreciation which was actually sustained in 1939, 1940 and 1941, is that correct?      A. Yes.

Mr. Woolf: In your opinion is that correct.

The Court: Just a minute. You will have an opportunity to cross-examine.

Q. (By Mr. Friedman): And getting back to the question we had before, if the 1934 settlement had been lived up to by the Commissioner and the

(Testimony of Sidney R. Reed.)

taxpayer, the Petitioner, there would be an allowance for depreciation on patents in the year 1940 in excess of that which has been allowed, and also a further allowance of some \$95,000.00 in the year 1941; is that correct?           A. Yes, sir.

### Recross-Examination

By Mr. Woolf:

Q. These last questions that Mr. Friedman has just asked you, and your answers, that is based on your opinion as to the computations?

A. As to the computations, yes, but the question of the proper amount of amortization in this matter was opened up by the Commissioner. It is the Commissioner who set aside the theory that he formerly established, back in 1934, and it was not the Petitioner that initiated the investigation of this amortization account.

Q. That is your opinion.

A. That is the fact. You see, I filed a return in accordance with [88] the books. It was the Examining Agent who contended the amortization claimed was too great. And the books reflected the settlement entered into in 1934 between the Petitioner and the Bureau.

Mr. Woolf: That is all, your Honor.

(Witness excused.)

The Court: We will recess until two o'clock.

(Thereupon, at 12:25 p.m., a recess was taken until 2:00 o'clock p.m. of the same day.)

## Afternoon Session

The hearing was resumed, pursuant to recess, at 2:00 p.m.

## SIDNEY R. REED

recalled as witness for and on behalf of the Petitioner, having previously been duly sworn, was examined and testified as follows:

## Direct Examination

By Mr. Friedman:

During the recess I have computed the amount of depreciation allocable to the years 1939, 1940 and 1941 on the average life method, assuming the Commissioner's cost of \$1,180,157.59. Without the \$55,021.36 adjustment, the depreciation would be \$95,430.50 for 1939, \$95,430.50 for 1940, and \$90,659.28 for 1941. With the \$55,021.36 adjustment, the depreciation would be \$99,880.23 for 1939, \$99,880.23 for 1940, and \$94,880.07 for 1941. I am familiar with the method of depreciation applied by this Court in the Simmons case. That method was to determine the number of unexpired months of all patents and to consider as amortization expense in a taxable year the proportion of the basis, in accordance with the number of months expiring in that year, to the total number of months. Applying that method to the figure \$1,235,178.95, which would be the basis used by the Commissioner plus the \$55,000.00 item, the amount of depreciation for 1939 would be \$58,817.28, for 1940, \$56,597.76, and for 1941, \$56,597.76. [89]

(Witness excused.)

Mr. Friedman: That is the Petitioner's case.

## HARLEY L. CLARKE

called as a witness for and on behalf of the respondent, having been previously duly sworn, was examined and testified as follows:

## Direct Examination

By Mr. Woolf:

My business address is 30 North LaSalle Street, Chicago, Illinois. I am an industrial engineer. In 1929 I was engaged in the utilities business and also owned the controlling interest in several companies such as the International Projector Corporation, Theatre Equipment Company. In 1929, I knew of a corporation known as General Theatres Equipment, Incorporated.

Q. In 1929, did you know of a corporation by the name of International Projector Corporation?

A. Yes.

Q. Did you own any stock in that corporation?

Mr. Friedman: If your Honor please, I object, on the ground that it is immaterial as having no bearing on this problem.

The Court: What is the materiality?

Mr. Woolf: Well, if your Honor please, I am leading up to show that General Theatres Equipment acquired certain corporations, owned and controlled certain corporations. The witness here is president of General Theatres, and he was acting on behalf of General Theatres in acquiring the four lamp companies and the stock of the Mitchell Camera Company. It is all part of one transaction.



(Testimony of Harley L. Clarke.)

The Court: Overrule the objection. Exception noted for the Petitioner. Proceed. [90]

Q. (By Mr. Woolf): In 1929, Mr. Clarke, did you know of a corporation known as General Theatres Equipment, Incorporated?

A. Yes.

Q. When was that corporation organized?

Mr. Friedman: If your Honor please, may my same objections go to these other questions, without repeating them each time?

The Court: Well, in order to do that, it is suggested that the Respondent make an offer as to what he proposes to show by this witness. Then you can make your objection, we will rule on it, and dispose of it once for all.

Mr. Woolf: I propose to show by this witness, if your Honor please, that General Theatres Equipment had \$11,400,000 allocated to Mr. Clarke to acquire certain companies, one of which was the Mitchell Camera Company of California.

I propose to show that General Theatres Equipment, Incorporated, acquired one-half of the stock of the Grandeur Corporation, which owned the stock of the Mitchell Camera Corporation of Delaware, the Petitioner here.

I also intend to show the transactions between Mr. Clarke and Mr. Fox, to show how the five million dollars was expended by Mr. Clarke in acquiring the corporations.

I also intend to show the consideration, how it passed from one corporation to another, and to

(Testimony of Harley L. Clarke.)

prove that the cost of all the properties, assets, patents and patent rights to the Petitioner here was not \$3,100,000.00.

The Witness: I remember appearing before the Committee on Banking and Currency, before the United States Senate, commonly called the Pecora Investigating Committee, on November 14 and November 22, 1933. The testimony I gave at that [91] hearing was under oath. Since that investigation I have not examined the record of the hearing. It was recorded. After reading the official copy of the hearing before the Committee on Banking and Currency, my memory is refreshed, and the answer recorded that the General Theatres Equipment Corporation was organized on July 11, 1929, is correct. The General Theatres Equipment Corporation was organized for the purpose of taking over the properties of the International Projector and other properties that were to be acquired. I owned sufficient stock in the General Theatres Equipment Corporation to give me control of the company. In 1929, I was an officer and controlling stockholder of the International Projector Corporation that was taken over by the General Theatres Equipment Corporation. In the early part of 1929, or the latter part of 1928, I desired to acquire certain companies engaged in manufacturing lamps and equipment for theatres. These were the J. E. McCauley Manufacturing Company, the Strong Electric Company, Ashcraft Automatic Arc Company, and Hall & Connelly, Incorporated. I do not think I had any

(Testimony of Harley L. Clarke.)

conversations with Mr. William Fox in regard to acquiring these four so-called lamp companies, and don't recall that I ever had any correspondence with Mr. Fox in regard to acquiring the Mitchell Camera Company of California.

I remember that letter which you show me, dated May 24, 1929, and reproduced at page 3719 of the reported hearings of the Committee on Banking and Currency. The letter was offered in evidence before that investigation.

(The document above referred to was received in evidence and marked Respondent's Exhibit C.)

The Court: That is a letter from whom to whom?

Mr. Woolf: I offer in evidence a letter addressed to Mr. William Fox, Fox Film Corporation, New York City, signed by Mr. H. L. Clarke.

The Court: That is the witness on the stand?

Mr. Woolf: That is the witness on the stand.

Q. (By Mr. Woolf): Is not that correct, Mr. Clarke? A. Yes.

Mr. Friedman: That letter is not offered as proof of the transactions mentioned in it?

Mr. Woolf: No.

The Witness: I remember on the same day addressing another letter to Mr. William Fox which was offered and received as an exhibit at the Pecora Investigation. I identify the copy which you show me from that record.

(Testimony of Harley L. Clarke.)

(The document above referred to was received in evidence and marked Respondent's Exhibit D.)

When I acquired the Mitchell Camera Company of California, I intended to put it into another company that would own it and some others. We had several names of companies we were organizing. It turned out to be General Theatres.

The Court: May I ask this question at this point: When you bought it, was there any control, oral or written, under which you were obligated, or any obligation was created, compelling you or obligating you to do anything with that?

The Witness: Only, your Honor, what is in writing here.

The Court: And is that in evidence here?

The Witness: This letter is in evidence.

The Court: Very well.

Q. (By Mr. Woolf): I show you on page 3440 of the reported document of hearings, Exhibit 135, which you introduced at the hearing, and I ask you to turn to page 3440 and examine it.

A. (Witness reads.) [93]

The Witness: The total amount received by General Theatres Equipment from certain securities sold on August 1, 1929, to Chase Securities, Pynchon, West, Hammonds, and Halsey and Stewart was \$11,400,000.00. Refreshing my recollection by examining this exhibit, those proceeds were used as follows:

(Testimony of Harley L. Clarke.)

International Projector Corporation, 25000 shares of preferred at 115.....	\$ 2,875,000.00
National Theatres Supply Company, 20000 shares of preferred at 107½.....	2,150,000.00
235,800 Five Year 6½% Sinking Fund Gold Notes at 105.....	247,590.00
Theatre Equipment Acceptance Corporation, 3000 shares \$6.00 dividend preferred stock at 110.....	330,000.00
2,000 shares, \$7.00 Dividend Preferred stock at 195 .....	210,000.00
Grandeur, Incorporated, 50000 shares 50% capital stock.....	2,000,000.00
J. McCauley Manufacturing Company—four companies in brackets—J. McCauley Manufacturing Company, Strong Electric Company, a corporation, Ashcraft Automatic Arc Company, Hall and Connelly, Inc.....	3,000,000.00
Cash for working capital.....	587,410.00
A total of.....	\$ 11,400,000.00

Q. Does not that mean that G.T.E. acquired those assets and that was the amount that they paid for them? A. Yes.

I had general direction of handling those transactions on behalf of G.T.E.

Again examining the exhibit, and refreshing my recollection, we paid \$1,131,422.93 for the J. E. McCauley Manufacturing Company, \$316,000.00 for the Strong Electric Company, \$160,000.00 for the Ashcraft Automatic Arc Company, and \$1,475,000.00 for Mitchell Camera. Now I think in fairness, if I may add something I would like to do it—on this Mitchell Camera Company and the J. E. [94] McCauley Company, very good sized commissions were paid on both of these deals. Some commissions were



(Testimony of Harley L. Clarke.)

paid outside of what appears on the exhibit. I would say on Mitchell Camera, perhaps three hundred and fifty, four hundred thousand dollars; I would say on the J. E. McCauley Manufacturing Company perhaps a couple of hundred thousand.

The General Theatres Equipment, Incorporated, acquired the four lamp companies and the interest in Grandeur for five million three hundred and twenty-two thousand odd dollars.

In 1929, I was President of General Theatres Equipment, Incorporated and of Grandeur, Incorporated. I don't remember whether in 1929 I was President of the Petitioner, or whether it was Mr. Green or Mr. Michael.

I obtained the \$1,475,000.00 which I paid for the assets and properties of the Mitchell Camera Company of California from financing. I can't earmark the dollars.

In 1929 General Theatres Equipment, Inc., acquired one-half the stock of Grandeur, Inc. at a cost of two million dollars, I believe. I made a payment to Mr. William Fox of two million dollars in connection with Grandeur, Inc. in 1929 I think.

Mr. Friedman: I have no objection to your reading the dates and amounts of the checks.

Mr. Woolf: All right. Check, New York, August 1, 1929: "Pay to the Order of William Fox, \$1,625,000.00," signed "H. L. Clarke." "Chase National Bank, New York," Endorsed "For Deposit,"

(Testimony of Harley L. Clarke.)

and check dated New York, August 1, 1929, "Pay to the order of William Fox, \$375,000.00, Chase National Bank, City of New York," signed "H. L. Clarke." [95]

The Witness: There was a written agreement between Mr. Fox and me as to what was to be done with that two million dollars. I don't know what Mr. Fox did with the two million dollars. Either Mr. Fox or somebody else acquired the other 50% of Grandeur, Incorporated. I don't know if he turned it over to anybody else or not.

I remember a contract entered into between Grandeur, Incorporated, and Fox Theatres Corporation in June, 1929. I identify the photostatic copy of the contract which you show me.

(The document above referred to was received in evidence and marked Respondent's Exhibit E.)

Refreshing my recollection from the minute book of the Mitchell Camera Corporation of Delaware which you show me, I was President in 1929.

The two million dollars which I paid to Mr. William Fox in 1929 was my own personal money. I couldn't ear mark the dollars.

I identify a copy of a letter dated May 25, 1929, addressed to Mr. William Fox, and signed by H. L. Clarke, which you show me.

(The document above referred to was received in evidence and marked Respondent's Exhibit F.)

(Testimony of Harley L. Clarke.)

During the period that I owned the Mitchell Camera Company of California and before the time that it was actually turned over to the Petitioner, I would say that the intent was that I owned the Mitchell Camera Company as agent or intermediary for General Theatres Equipment, Incorporated.

The financing by which I acquired Mitchell Camera Company of California was out of the financing of General Theatres Equipment, Inc.

Q. Mr. Clarke, actually, of the four million dollars that was paid into Grandeur, Inc., \$3,100,000.00 came back to you, is that correct?

A. Came back to me?

Q. Yes. A. Personally, you mean?

Q. To you personally. [96]

A. Came back to me probably in the form of stock. I can't answer your question any better than that.

Q. Four million dollars, I believe the record shows, was paid into Grandeur, Inc., for all of its capital stock. Is that correct?

A. I think that is correct. I say I think because I——

Q. Now, for your interest and your ownership of the Mitchell Camera Company of California, you received back \$3,100,000 of that \$4,000,000; is that correct?

A. Well, when you say received back, are you saying that Grandeur paid three million one hundred thousand for Mitchell?

(Testimony of Harley L. Clarke.)

Q. I am saying that you, either personally or on behalf of General Theatres Equipment, Inc., received \$3,100,000 in return for which the Petitioner here received the assets and properties, patents, patent applications—all of the property of the Mitchell Camera Company of California.

A. I think that is correct, but I am not too definite about it.

Q. Well, there is no question about your receiving \$3,100,000, is there?

A. When you say “you,” you mean General Theatres, or H. L. Clarke?

Q. That is what I am trying to bring out.

A. I want to answer your question directly.

The Court: Well, do you mean whether or not the witness did?

Q. (By Mr. Woolf): Did you, acting for yourself or on behalf of General Theatres Equipment, Inc., receive back \$3,100,000 of the \$4,000,000 that was paid into Grandeur for its stock?

A. I think that is correct. I would like to add to it, though, that it would be possible for me to find that out and let you know. I will make the answer that way, with the understanding that if I want to change it, I can. [97]

It is correct that General Theatres Equipment, Inc. acquired one-half of the stock of Grandeur for two million dollars, and that I gave two checks totaling two million dollars to Mr. William Fox. I think it is correct that Mr. Fox paid in two million dollars for a half interest in Grandeur, but I have nothing

(Testimony of Harley L. Clarke.)

in front of me or in my memory to say yes. The \$3,100,000 that I received for the transfer of the assets of the Mitchell Camera Company of California to the Mitchell Camera Corporation of Delaware came out of the financing of General Theatres.

Mr. Fox was given stock of General Theatres Equipment, but whether it was at the time he was given the two checks for two million dollars, I don't know.

(Thereupon there was offered and received in evidence, as Respondent's Exhibit G a copy of Senate Committee Exhibit No. 135, containing figures as to which the witness had previously testified.)

### Cross-Examination

By Mr. Friedman:

I acquired certain companies—McCauley Manufacturing, Strong Electric, Ashcraft Automatic Arc, and Hall and Connelly. I think they were acquired in my name. I paid a total of \$1,699,422.93 for these properties, and sold them to someone—General Theatres or someone—for three million dollars. I purchased the assets of the Mitchell Camera Company of California for \$1,475,000.00. In addition to the \$1,475,000, I paid commissions on the Mitchell Camera Corporation acquisition of between \$350,000 and \$400,000. The purpose of acquiring the Mitchell Camera Company of California was particularly to manufacture a larger camera which would use the 70 millimeter instead of the 35 millimeter film. The



(Testimony of Harley L. Clarke.)

Mitchell Camera Company of California had a number of patents which we acquired when we bought the business. The business of the Mitchell Camera Company was the manufacture, under patents, of motion picture cameras. In order to get the [98] right to manufacture the motion picture cameras, I had to have the patents of the corporation. I was particularly seeking, in acquiring the Mitchell Camera Corporation of California, the right to build these 70 millimeter cameras.

I believe it is correct that four million dollars was paid into Grandeur for its stock, two million of which was paid in by General Theatres. Of that four million dollars, Grandeur used \$3,100,000 to acquire the stock of the Mitchell Camera Corporation of Delaware, leaving a balance of \$900,000 in the treasury of Grandeur. The Mitchell Camera Corporation of Delaware then paid \$3,100,000 out of its funds to acquire the assets from me under my offer of July 12, 1929. I do not recall whether or not the payment to me went into my personal bank account.

The monies which I paid to Mr. Fox came out of my personal funds. I had sufficient funds to cover this \$2,000,000 payment without the \$3,100,000 which I received from the Mitchell Camera Corporation.

I do not know whether the deposit of \$3,000,000 on August 2, 1929, which you show me from a transcript of my account in the Chase National Bank came from the Petitioner. I don't know where it

(Testimony of Harley L. Clarke.)

came from. I do not know to whom the payment of \$3,000,000 shown in the account of the Mitchell Camera Corporation of Delaware was paid. I do know that under the agreement of July 12, 1929, I was to receive \$3,100,000 from Mitchell Camera Corporation of Delaware.

Q. Did you sell Grandeur the stock, or did you sell it the assets of the Mitchell Camera Corporation for the \$3,100,000 you got from Mitchell Camera?

A. Yes.

Q. And you got the consideration named there, did you? A. Yes.

Q. Now, you sold the assets not to Grandeur, but to Mitchell Camera of Delaware, is that correct?

A. That is my recollection, yes. [99]

Q. Will you refresh your recollection from those minutes and answer the question yes or no?

A. Yes.

I assume I had a written agreement with General Theatres Equipment relative to these transactions. I do not have it with me. I remember Murrey W. Dodge of the Chase Bank. I do not recall that he testified before the Senate Committee that I was acquiring these properties on my own behalf.

Q. I ask you whether you turned over the profit which you made in these transactions to the General Theatres Equipment, Incorporated?

A. Yes, I made no profit out of any transaction of the General Theatres Company.

Q. Let us canvass that a minute.

A. O.K. I would like to have you. Internal Revenue has done a good job of it.

(Testimony of Harley L. Clarke.)

The Witness: I received, in these two transactions, \$6,100,000.00. Of that money, I paid out \$1,699,000 for the lamp companies. I paid out \$1,475,000 plus \$350,000 or \$400,000 for Mitchell. If your arithmetic is correct, that would be a total of \$3,565,000. And for those assets I received \$6,100,000. I do not have any check with me showing the payment of the balance of that money to General Theatres Equipment, nor do I recollect how the transactions were handled. If you are interested, it will be possible to find out. I think that the difference between the \$3,000,000 I got for the sale of the lamp companies and the \$1,699,000 I paid for the lamp companies all checked out; I have no record of giving an accounting to the General Theatres Equipment Company for this difference. When I first started to purchase this property, General Theatres Equipment Company was not even organized. After I contracted to purchase these properties, I think I could have transferred them to any place I wanted to. So I could not have been acting specifically as agent for General [100] Theatres Equipment Company at that time.

The money which was used in this financing was public money from stock sold to the public—\$11,400,000. I bought some of the stock myself. Again reading Respondent's Exhibit C, I don't recall whether another contract superseded this, and some other deal made. I don't recall whether I paid the \$250,000 referred to in the third paragraph of

(Testimony of Harley L. Clarke.)

that letter. This letter says I agreed to do it, so I assume I did it. If any changes were made, I don't recall them.

(Witness excused.)

(Thereupon, at 4:30 o'clock p.m. an adjournment was taken until the following day, Wednesday, October 23, 1946, at 9:30 o'clock a.m.)

(The Court met pursuant to adjournment.)

### WILLIAM FOX

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

#### Direct Examination

By Mr. Woolf:

My address is 272 Park Avenue, New York City. I am the General Manager of the Mitchell Camera Corporation. In 1929 I was engaged in the motion picture business. I was also president of the Fox Film Corporation and the Fox Theatres Corporation from the time of their inception in 1915 and 1925, respectively. I recall the organization of Grandeur, Incorporated, which I believe is still in existence. At the present time the stock of that corporation is owned by the All Continent Corporation, a holding corporation. The stock of the All Continent Corporation is owned by Mrs. Eva Fox,

(Testimony of William Fox.)

my wife. Belle Fox and Mona Fox are my daughters. Grandeur, Inc. was organized during the year 1929. [101] Upon organization of Grandeur, Incorporated, I acquired one-half of the stock and the Harley L. Clarke interests acquired the other half. I was confined to the hospital at the time when Mr. Clarke testified he gave me two checks in the total amount of two million dollars. I later learned that he had given us two checks, and that we had given the Harley Clarke interests some checks in return. I caused to be paid into Grandeur, Incorporated a check for \$1,950,000.00 for my one-half interest in Grandeur stock. It was in exchange for the checks that Clarke gave me.

Mr. Friedman: I concede that a check was issued by Mr. Fox and signed by someone authorized payable to Grandeur, Incorporated for \$1,950,000 on August 1, or thereabouts, for stock in Grandeur, Incorporated. Here it is.

(The document above referred to, having been first identified by the witness, was offered and received in evidence and marked Respondent's Exhibit H.)

The Witness: I paid nothing for the stock of Grandeur Incorporated. I got that as part of a transaction between Harley Clarke and myself. It seems that I had gotten two million dollars of checks, and gave Grandeur Incorporated two million dollars of checks. I think some time in the month of May, Mr. Clarke asked me for a check of



(Testimony of William Fox.)

\$50,000. But all those transactions that Clarke had had, and various letters he had written me during the month of May and the early part of June, all of them were dissolved, and none of them carried out, and a new transaction was entered into the latter part of June or early part of July 1929. In accordance with my understanding with Mr. Clarke, I was not to pay any money for my half interest in Grandeur, Incorporated. I was to give him something else in return for it. In 1929 I also received from Mr. Clarke 25,000 shares of stock of General Theatres Equipment.

Q. (By Mr. Woolf): Mr. Fox, I hand you a document, and ask you if that is your signature?

A. Yes, sir.

Mr. Woolf: Your Honor, I offer in evidence the Closing Agreement for the years 1930 and 1931, which was signed by Mr. Fox, the witness on the stand, for the purpose of showing the basis that was arrived at for depreciation in regard to those two years, and which was followed by the Bureau and the taxpayer from then on.

Mr. Friedman: If your Honor please, I have no objection to it, except that it is not a Closing Agreement. It is what is known as "Waiver of Restrictions on Assessment and Collection of Deficiency in Tax," Form 870. With that correction, I have no objection to the offer, to show the prior history of the case.

The Court: Do you accept the correction?

(Testimony of William Fox.)

Mr. Woolf: I accept the correction, your Honor. It speaks for itself.

The Court: Received.

(The document above referred to was received in evidence and marked Respondent's Exhibit I.)

Mr. Woolf: I offer in evidence copy of the Commissioner's acceptance of the Waiver, which was mailed to Grandeur, Incorporated.

Mr. Friedman: No objection.

The Court: Received.

(The document above referred to was received in evidence and marked Respondent's Exhibit J.)

Mr. Woolf: That is all from this witness, your Honor.

### Cross-Examination

By Mr. Friedman:

Q. Mr. Fox, will you please state what the transaction was that you finally carried out between you and Mr. Clarke relating to the matter we are now discussing—Mitchell Camera Corporation of Delaware? [103]

Mr. Woolf: Is that proper cross-examination, or are you making him your witness?

Mr. Friedman: I am examining him on the questions you asked relating to his transactions with Mr. Clarke. You asked him some questions relating to that. He said the agreements were not

(Testimony of William Fox.)

carried out, and I am cross-examining him on that.

The Court: May we ask you a question? What is your interest in the Petitioner company?

The Witness: Well, my family owns the Petitioner company.

The Court: Is this witness's testimony inconsistent with that of the witness Clarke?

Mr. Friedman: Yes, your Honor, to this extent; in his explanation he stated that the agreements that have been introduced, agreements in writing, were not carried out.

(At this point in the testimony the Court granted an earlier motion made by Respondent that the witness be treated as an adverse witness to Respondent.)

The Witness: I had over a long period of time developed a new camera called the Grandeur camera and I presume that I had expended three or four hundred thousand dollars on it and it was probably the most revolutionary thing in the business with the exception of sound-on-film. Grandeur was the name we gave to the camera on account of its width. It was a 70 millimeter camera, twice the width of the present film now being used. Mr. Clarke had communicated with me about this development and we entered into negotiations. The result of the negotiations had with Mr. Clarke were as follows: He was to create a company called Grandeur, Incorporated. I was to receive one-half of the stock. When the transaction was completed, Grandeur, In-

(Testimony of William Fox.)

corporated was to have as its assets the Mitchell Camera Company of Delaware, and all of the experimental work that I had [104] done on Grandeur, and in addition to the half interest that I was to have in Grandeur, Inc., he was to give me 25,000 shares of General Equipment stock.

The Court: Is that General Theatres?

The Witness: General Theatres Equipment stock. That was how the transaction was concluded between Mr. Clarke and myself. Now the inner workings of the deal he worked out, and how he did it, I don't know a thing about that. It was concluded by Clarke at the time that the Mitchell Camera Corporation and the Grandeur Company would form a most wonderful combine, and the patents of the Mitchell Camera Corporation with the patents of Grandeur were required to complete the transaction and control the wide film situation.

At that time the Mitchell Camera Company of California had built a Grandeur camera for us, partly under their patents and partly under ours. The purpose of Mr. Clarke and myself in acquiring Mitchell of California was to secure its patents. That is to say its machinery and its building meant nothing to us. It controlled the patents of the 35 Millimeter film. The value of Mitchell had to Grandeur, was the value of its patents. My interest in Mitchell was based entirely upon the patents which it owned, not upon its good will, or its machinery or buildings.

(Testimony of William Fox.)

Cross-Examination

(See ruling)

By Mr. Woolf:

The patents of the Grandeur camera were assigned to me by the inventor, I think some time in 1927 or 1928. Whatever I had in connection with Grandeur was transferred to Grendeur, Incorporated. I presume I transferred patents to Grandeur, Incorporated. They were either patents or patents pending or inventions. Whatever we had that caused us to spend between four and five hundred thousand dollars developing the wide camera, was transferred to Grandeur, Inc. I don't know whether those patents were on the balance sheet of Grandeur, Inc. [105]

Q. Were any of those patents of Grandeur transferred to the Mitchell Camera Corporation, the Petitioner here? A. I don't know, sir.

Q. Were any of them in this list?

The Court: The witness is now being shown what?

Mr. Woolf: He is being shown Petitioner's Exhibit 8 attached to the stipulation of facts.

The Witness: My understanding is that this list contains patents created by the Mitchell Camera Corporation itself.

Q. (By Mr. Woolf): And no Grandeur patents there, is that your answer?

A. Well, this is a list of the Mitchell Camera Corporation patents.

Mr. Woolf: That is all, if your Honor please.

(Witness excused.)



(Thereupon there were offered and received in evidence the tax returns filed by Grandeur, Inc., for the years 1929, 1930, 1932 and 1933, together with the respective audit reports and marked Respondent's Exhibits K, L, M, and N, respectively. There were also offered and received in evidence the tax returns filed by the Mitchell Camera Corporation for the years 1934, 1935, 1936, 1937, 1938, 1939, 1940, and 1941, and marked Respondent's Exhibits O, P, Q, R, S, T, U, and V respectively.)

The Court: Have you a question, Mr. Woolf?

Mr. Woolf: If your Honor please, yesterday there was a witness from the Chase National Bank of New York, who had the transcript of the accounts of Mr. Clarke and Mitchell Camera. Mr. Friedman asked me if I had any objection to his being excused, that he had left photostatic copies of the accounts with him, and I could examine the originals. I stated that there was no objection. I now ask that those be produced in order that they may be offered in evidence.

Mr. Friedman: Well, I have the photostats, but what is the purpose of the offer? That does not make them admissible. [106]

Mr. Woolf: I offer them for the purpose of showing the \$3,000,000 check on August 2, 1929 of the Mitchell Camera Corporation, for the purpose—

Mr. Friedman: Of showing that they received it and paid it, or what?

Mr. Woolf: For the purpose of showing the check dated August 2, 1929 for \$3,000,000, of the Mitchell Camera Corporation.

Mr. Friedman: Well, that check was the check of Grandeur. Do you want to introduce it to show that the Grandeur check was deposited in the account of the Mitchell Camera Corporation, and that Mitchell Camera disbursed \$3,000,000, which appears in the account of Harley L. Clarke on the same date?

Mr. Woolf: Yes.

Mr. Friedman: No objection, for that purpose.

The Court: Received.

(The document above referred to was received in evidence and marked Respondent's Exhibit W.)

The Court: Is there anything further for the Respondent?

Mr. Woolf: No, your Honor.

Mr. Friedman: If your Honor please, may I make one motion? I should like to move to conform the record to the proof with respect to the item of \$55,000 we have referred to in the testimony, and also with respect to the additional cost paid by H. L. Clarke of \$350,000 in connection with the acquisition of Mitchell Camera Corporation of California.

Mr. Woolf: I object, your Honor, as not timely made. He does not have it in writing ready to submit this morning.

The Court: Is that all?

Mr. Woolf: That is all.

The Court: Motion granted. We would like for you to put it in writing as of now, and file the amendment to conform the pleadings to the proof. We think the Petitioner has the right to amend its pleadings in the [107] way it indicates.

Mr. Woolf: The respondent will have the right to file an answer?

The Court: We understand, of course, that you will file a general denial. Is that so?

Mr. Woolf: That is correct.

The Court: That will also be put in writing, as of today.

(Whereupon, at 10:30 o'clock a.m., the hearing in the above-entitled matter was concluded.)

The foregoing is the substance of all the material evidence adduced at the hearing in this cause, and the Petitioner tenders and presents the foregoing as a statement of the evidence in the cause and prays that the same be approved by the Tax Court of the United States and made a part of the record in this cause.

/s/ HARRY FRIEDMAN,

Attorney for the Petitioner,

The above and foregoing statement of evidence contains the substance of all the evidence material for a review of the rulings and decisions assigned as error herein and the same be approved by the Tax Court without notice.

/s/ CHARLES OLIPHANT, CAR

Chief Counsel, Bureau of  
Internal Revenue.

Filed T.C.U.S. Jan. 2, 1948. [108]

[Title of Circuit Court of Appeals and Cause.]

### MOTION

Whereas the Petitioner above-named has heretofore filed a Petition for Review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision entered herein by the Tax Court of the United States, and

Whereas the Petitioner intends to include as part of the record on review of this case:

1. The stipulation of facts filed on October 22, 1946, with Petitioner's Exhibits 1 to 10, inclusive, attached thereto,
2. Petitioner's Exhibits 11 to 18, inclusive, filed at the hearing, and
3. Respondent's Exhibits A to W, inclusive, filed at the hearing.

Now, Therefore comes the Petitioner, by its attorneys, and moves that the Court enter an order providing that the above-described exhibits be omitted from the printed record on review, and in lieu thereof the Clerk of the Tax Court be directed to transmit to this Court the said exhibits in original form, [109] for the reason that there are many Exhibits, some of which are already in printed form, and the other Exhibits are voluminous and the cost of printing them would be excessive; provided however, that the above described Exhibits remain in the custody of the Clerk of the Tax Court of the United States until ten days before this cause

on review is set for argument in this Court, and then, upon direction of counsel for Petitioner on Review, be transmitted to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit; and, that the Clerk of this Court transmit to the Clerk of the Tax Court of the United States a certified copy of the order entered herein.

Dated: December 17th, 1947.

/s/ HARRY FRIEDMAN,

/s/ BIRGER TINGLOFF,

Attorneys for Petitioner  
on Review.

No Objection:

/s/ CHARLES OLIPHANT,

Chief Counsel, Bureau of Internal Revenue, Counsel  
for Respondent on Review.

So Ordered:

FRANCIS A. GARRECHT,

Senior United States

Circuit Judge.

A True Copy.

[Endorsed]: Filed Dec. 23, 1947,

PAUL P. O'BRIEN,

Clerk.

Filed T.C.U.S. Dec. 29, 1947.

Received Jan. 6, 1948. [110]



[Title of Circuit Court of Appeals and Cause.]

DESIGNATION OF PORTIONS OF RECORD,  
PROCEEDINGS AND EVIDENCE TO BE  
TRANSMITTED TO THE CIRCUIT COURT  
OF APPEALS

To the Clerk of the Tax Court of the United States:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, copies duly certified as correct of the following documents and records in the above-entitled proceeding in connection with the Petition for Review by the Circuit Court of Appeals for the Ninth Circuit, heretofore filed by the Mitchell Camera Corporation:

1. Docket entries of all proceedings before the Tax Court.

2. Pleadings before the Tax Court:

(a) Amended Petition filed November 4, 1946, including annexed copy of deficiency letter.

(b) Answer to amended Petition.

3. Stipulation of Facts.

3a. Exhibits in original form pursuant to Court Order of December 23, 1947.

4. Findings of Fact, Opinion and Decision.

5. Motion to vacate and set aside the Memorandum Findings of Fact and Opinion, filed July 24, 1947, and notation of denial of motion on July 25, 1947.

6. Petition for Review, together with proof of service of notice of filing, and of service of a copy, of Petition for Review.

7. Statement of Points to be relied upon by the Petitioner.

8. Statement of Evidence as settled and allowed.

9. Court order extending time for the preparation, transmission and delivery of the typewritten transcript of the record on review.

10. Court order for the transmission of exhibits in original form and omission of exhibits from printed record on review.

11. This designation of portions of the record, proceedings and evidence to be contained in the printed record on review.

Said transcript to be prepared, certified and transmitted, as required by law and the rules of the United States Circuit Court of Appeals for the Ninth Circuit.

/s/ HARRY FRIEDMAN,  
Attorney for Petitioner  
on Review.

Service of a copy of the within designation is hereby admitted this 2nd day of Jan., 1948.

/s/ CHARLES OLIPHANT, CAR  
Chief Counsel, Bureau of Internal Revenue, Coun-  
sel for Respōndent on Review.

Filed T.C.U.S. Jan. 2, 1948. [112]

The Tax Court of the United States  
Washington

Docket No. 8058

MITCHELL CAMERA CORPORATION,  
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

### CERTIFICATE

I, Victor S. Mersch, clerk of the Tax Court of the United States do hereby certify that the foregoing pages, 1 to 112, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 7th day of January, 1948.

[Seal]      /s/ VICTOR S. MERSCH, EMT  
Clerk, The Tax Court of  
the United States.

[Endorsed]: No. 11829. United States Circuit Court of Appeals for the Ninth Circuit. Mitchell Camera Corporation, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record Upon Petition to Review a Decision of the Tax Court of the United States.

Filed January 12, 1948.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals  
for the Ninth Circuit.

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United States Circuit Court of Appeals  
for the Ninth Circuit

T. C. Docket No. 8058

MITCHELL CAMERA CORPORATION,  
Petitioner on Review.

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent on Review.

**MOTION FOR EXTENSION OF TIME FOR  
TRANSMITTING RECORD ON REVIEW**

Whereas, the petitioner on review on November 3, 1947, filed its petition for review from a decision of The Tax Court of the United States and notice thereof and the time for transmitting the record on review will expire, under Rule 30, on December 13, 1947, and

Whereas, counsel for petitioner have submitted a narrative statement of evidence to counsel for

respondent and said statement has not been settled, and therefore the record on review cannot be completed and transmitted to this Honorable Court within the time allowed because of conditions beyond the control of counsel, and additional time is required to complete file and transmit the record to this Honorable Court.

Now, Therefore, the petitioner for review by its counsel, Harry Friedman and Birger Tinglof, respectfully moves that the time within which to complete and transmit the record on review in this proceeding be extended to and including January 20, 1948.

/s/ HARRY FRIEDMAN,  
/s/ BIRGER TINGLOF,  
Counsel for Petitioner  
on Review.

No Objection:

/s/ CHARLES OLIPHANT,  
Counsel for Respondent  
on Review.

So Ordered:

FRANCIS A. GARRECHT,  
Senior United States  
Circuit Judge.

A True Copy: Attest: /s/ Paul P. O'Brien,  
Clerk.

[Endorsed]: Filed December 8, 1947. Paul P.  
O'Brien, Clerk.

Filed T.C.U.S. December 12, 1947.



[Title of Circuit Court of Appeals and Cause.]

PETITIONER'S DESIGNATION OF THE  
PARTS OF THE RECORD TO BE PRINTED

To the Clerk of the United States Circuit Court of  
Appeals for the Ninth Circuit:

The Mitchell Camera Corporation, the Petitioner on Review herein, by its attorney, Harry Friedman, pursuant to its Petition for Review of the decision of the Tax Court of the United States entered September 9, 1947, designates the parts of the record considered material to the questions on review to be included in the printed transcript of the record, as follows:

1. Docket entries of all proceedings before the Tax Court.
2. Pleadings before the Tax Court:
  - (a) Amended Petition filed November 4, 1946, including annexed copy of deficiency letter.
  - (b) Answer to amended Petition.
3. Stipulation of Facts.
4. Findings of Fact, Opinion and Decision.
5. Motion to vacate and set aside the Memorandum Findings of Fact and Opinion, filed July 24, 1947, and notation of denial of motion on July 25, 1947.

6. Petition for Review, together with proof of service of notice of filing, and of service of a copy of Petition for Review.

7. Statement of Points to be relied upon by the Petitioner.

8. Statement of Evidence as settled and allowed.

9. Court order extending time for the preparation, transmission and delivery of the typewritten transcript of the record on review.

10. Court order for the transmission of exhibits in original form and omission of exhibits from printed record on review.

11. Designation of portions of record, proceedings and evidence to be transmitted to the Circuit Court of Appeals.

12. This designation of the parts of the record to be printed.

/s/ HARRY FRIEDMAN

/s/ BERGER TINGLOF

Attorneys for Petitioner on  
Review.

Service of a copy of the designation of the parts of the record to be printed is hereby admitted this 15th day of January, 1948. Agreed to:

/s/ THERON LAMAR CAUDLE,

Assistant Attorney General.

[Endorsed]: Filed Jan. 20, 1948.